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IN THE

Supreme Court of the United States

Appeal from The Supreme Court of Ohio.

OCTOBER TERM, 1936.

No. 539.

THE OHIO BELL TELEPHONE COMPANY,
Appellant,

vs.

THE PUBLIC UTILITIES COMMISSION OF OHIO,
Appellee.

APPELLEE'S BRIEF.

HERBERT S. DUFFY,
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DONALD C. POWER,
Special Counsel,
For Appellee.
March 27, 1937.

TOOTHAKER & RODENFELS, Law Printers, Columbus, Ohio.

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APPELLEE'S BRIEF.

STATEMENT OF THE CASE.

Appellant, The Ohio Bell Telephone Company, seeks to reverse a judgment of the Supreme Court of Ohio, entered against it on July 22, 1936, affirming the findings

and orders of The Public Utilities Commission of Ohio of January 16, March 1, July 5, July 9 and September 6, 1934.

While separate appeals were taken by The Ohio Bell Telephone Company to the Supreme Court of Ohio for the purpose of reviewing the various orders of the commission hereinabove referred to, all of said appeals were consolidated into one case, briefed and argued as such and decided in one opinion. (R., 3, 533.)

Throughout this brief, the appellant, The Ohio Bell Telephone Company, will be referred to as the "company" and the appellee, The Public Utilities Commission of Ohio, will be referred to as the "commission".

History of the Case.

The proceedings presented for review arise out of the action of the commission subsequently affirmed by the Supreme Court of Ohio in what has come to be known as the state-wide Ohio Bell Telephone case, being properly so designated because it involved an inquiry into the value of the property and rates of that company for both exchange and toll service throughout the state of Ohio. (R., 714.)

Prior to the year 1914, Bell System service in Ohio was limited to the portions of the state served by The Cleveland Telephone Company, the Central Union Telephone Company, the Central District Printing and Telegraph Company and the Cincinnati & Suburban Bell Telephone Company, (the latter still operating as a separate company). (R., 6485, 6492A.) At the same time and

operating independently in the same territory in many localities were other telephone companies.

In July, 1914, a number of companies of the kind last referred to were consolidated under the name of The Ohio State Telephone Company. (R., 6365-7.) In December, 1920, The Cleveland Telephone Company (its name having been changed to The Ohio Bell Telephone Company) purchased the Ohio property of Central Union Telephone Company. (R., 6485.) In September, 1921, The Ohio Bell Telephone Company and The Ohio State Telephone Company were consolidated as The Ohio Bell Telephone Company (R., 6358-60), and that company thereafter purchased additional telephone properties. (R., 6488-6492A.) Even after these extensive consolidations there remained more than 450 other independent telephone companies operating in the state.

As soon as The Ohio Bell Telephone Company (consolidated) was ready to unify the service in communities having a dual service, it filed with the commission an application to determine the rates chargeable for such unified service. In the case of some of the exchanges the municipalities concerned contested the proposed rates and a hearing was instituted. Subsequently, following the 1923 amendment of *Section 614-20* of the Ohio Code *(110 Ohio Laws, 366)*, the company filed new rate schedules for many of its exchanges; some of which were protested by the municipalities concerned and were collected under bond, after the end of the statutory period of suspension. This was true also with respect to the com-

pany's new schedule of toll rates for its toll service throughout the entire state. (R., 6490-92.)

As a result, many extensive hearings were had by the commission, and in the two years prior to October, 1924, several thousand pages of testimony were taken and an even greater number of pages of exhibits offered in evidence. (R., 6491-2.)

On October 14, 1924, the commission, having found that many issues were common to all of the then pending Bell cases, both toll and exchange, ordered that they be consolidated and that the examination into the rates proceed as a single state-wide case involving all the rates and services, exchange and toll, of The Ohio Bell Telephone Company, including those then under investigation, and that the evidence theretofore introduced, in the several separate cases, be considered and made a part of the record in the consolidatd cases. (R., 714-17.)

This order concluded as follows:

> "Ordered, that, on or before December 1, 1924, said the Ohio Bell Telephone Company furnish to this commission and file in this cause, as a part of the evidence therein, a complete inventory of all of its property located in the state of Ohio and used and useful and to be used and useful, in the furnishing of telephone service therein, both toll and exchange, classified according to the classification adopted and prescribed by this commission and the Interstate Commerce Commission for telephone companies, and that, upon the filing of such inventory, this consolidated case proceed to a hearing for the determination of the fair value of said property and of the just and reasonable rates for the service thereby to be furnished by said company to its patrons throughout the state of Ohio."

By this order, forty-three separate cases then pending, the majority of which were for increased rates, were consolidated into the state-wide case*.

Following the order of consolidation, the company made additional filings of exchange rates, some of which were protested by the municipalities involved and subsequently, collected under bond. (R., 6490.)

The company filed and offered in evidence an inventory and appraisal of its entire property. (R., 7421.)

In February, 1927, the case was submitted to the commission for the fixing of a tentative value, but before this valuation was announced, the then attorney general requested that the case be re-opened and further valuation testimony taken. (R., 123.)

Following that date much time was consumed in taking testimony on behalf of the state, with rebuttal evidence on behalf of the company, and in April of 1930 the case

* Note: Under the provisions of the Ohio law then in effect (The Pence Law, Section 614-20, passed April 4, 1923, 110 Ohio Laws, 366, which amended the Robinson Law, 108 Ohio Laws, 1094, and which has since been repealed, 113 Ohio Laws, 17) a public utility could increase its rates by filing with The Public Utilities Commission of Ohio a schedule of the proposed rates and the commission upon complaint or upon its own initiative without complaint could suspend the effective date of said increased rates for a period of not to exceed one hundred and twenty days and at the end of the suspension period if the validity of the increased rates had not then been established the increased rates would become effective upon the public utility filing with the commission a bond or other security, guaranteeing the repayment, with interest at 6% from the date of payment by the consumer until the date of repayment by the utility of any excessive rates found by the commission to have been collected.

was again submitted to the commission for its finding on tentative value. (R., 3224.) This tentative valuation finding was issued on January 10, 1931 (R., 121, 144), and wherein the commission found the present value of the total property of the company as of June 30, 1925 (pursuant to *Sec. 499-9* of the Ohio General Code, the commission adopted June 30, 1925, as the "date certain" for the purpose of valuing appellant's property; R., 126, 166), to be $104,282,735.

On February 7 and February 9, 1931, protests to this finding were filed on behalf of the company and the state respectively. Hearings on the protests were held on March 3 and 4, 1931. At that time counsel for the company stated that the company was then preparing exhibits to show Western Electric profits, cost of license contract services rendered by American Telephone & Telegraph Company and separation of plant revenues, and expenses, as between interstate and intrastate usage in accordance with the interpretation which counsel placed upon the decision of the Supreme Court of the United States in the case of *Smith v. Illinois Bell Telephone Company,* 282 U. S., 133.

On April 17, 1931, hearings were resumed for the presentation of this testimony proffered by the company.

On June 17 and 18, 1931, during the cross examination of Mr. Charles A. Heiss, comptroller of American Telephone and Telegraph Company, and Mr. R. H. Gregory,

comptroller of Western Electric, certain requests were made for detailed information underlying their exhibits and testimony. (R., 3520-26, 3537-3538.) In July of that year the company furnished certain data in accordance with its version of these requests. (R., 8213 et seq.; 8248 et seq.)

A hearing was had on September 28, 1931, on the requests and a few days later a revised list, dated October 1, was submitted.

On December 5, 1931, the company filed a brief styled "memorandum responsive to state's official request for information." A reply to the company memorandum was filed with the commission on December 28, 1931. The matter again came on for hearing on January 27, 1932.

On April 22, 1932, the commission issued its order in regard to the requests, approving some, denying others, and directing the attorney general and the company to expedite the proceedings. (R., 8305.)

The company continued to furnish data in compliance with this last order, the last being received on June 22, 1932. Practically all of the data requested related to American Telephone & Telegraph Company and Western Electric Company.

During the entire year 1932 the Chicago case of Illinois Bell was going forward, volumes of testimony and exhibits being introduced at hearings before Judge Wilkerson, as a result of the decision of the Supreme Court of

the United States remanding that case to the statutory court for further findings. (*Smith v. Illinois Bell Telephone Company*, 282 U. S., 133.) This evidence so introduced in the Illinois case relating to the same general issues that were being presented to the Ohio commission.

Hearings were concluded and that record (Chicago case) closed early in the fall of 1932 and all of the issues thoroughly briefed by counsel on each side. Five days were allotted early in December for oral argument before the full statutory court of three judges at which time that case was submitted for decision.

Subsequently, it was found that the material furnished by the company in professed compliance with the request made in June was inadequate and not responsive.

A great deal of time would have been necessary to formally introduce the same or similar testimony into the record of this case so when hearings were resumed in this case on December 19, 1932, before the commission a stipulation was worked out between counsel to file therein the testimony and exhibits in the Chicago case in so far as it related to the four issues, namely, Western Electric profits, American Telephone and Telegraph license contract service costs, separation of interstate and intrastate plant, revenues and expenses, and rate of return. As a result of this stipulation many days of hearing were saved. The stipulation provided, in substance, that the new record made in the Chicago case be incorporated in this record covering the testimony of certain specified witnesses and exhibits introduced through them and it also provided that all such evidence was introduced sub-

ject to the same objections made in the Chicago case. Certain additional exhibits relating to the Ohio company were introduced by stipulation, such exhibits having been prepared in the same manner as their correspondingly numbered exhibits in the Chicago case. The stipulation further provided for the introduction into this record of the requests made on behalf of the state, heretofore referred to, and the material furnished by the company in response thereto.

On December 29, 1932, the record in this case was closed on the introduction of certain testimony and exhibits of company witnesses and Mr. E. W. Wood on behalf of the state. Subsequently, under date of January 16, 1934, the commission made and entered its final order in this case (R., 154, 247), fixing the value of the property of The Ohio Bell Telephone Company as of June 30, 1925, the date certain in this case, and for each of the years subsequent thereto, through the year 1933. Thereafter the commission's orders of March 1, July 5, July 9 and September 6, 1934, followed. (R., 273; 303; 308; 372.)

Orders and Opinions in the Case.

The commission's order of January 16, 1934 (R., 247) based upon its opinion and finding of the same date (R., 154) corrected by its order of March 1, 1934 (R., 273) fixed the final valuation of the intrastate property of The Ohio Bell Telephone Company at $93,707,488 as of June 30, 1935, the "date certain." The value for each succeeding year to and including 1933 was also fixed by the

commission. The above described orders also required The Ohio Bell Telephone Company to refund to its subscribers in the state of Ohio the sum of $13,289,172 which amount the commission found to be the excess earnings of The Ohio Bell Telephone Company from its entire intrastate operations for the years 1925 to 1933 inclusive, and further directed The Ohio Bell Telephone Company to file a schedule of reduced rates effective as of June 30, 1925, and thereafter, until changed by order of the commission. Subsequently, the commission made two reductions in the amount of refunds originally ordered. The first reduction of $1,121,494 was made in the commission's order of July 5, 1934 (R., 303) for the reason that a part of the excess earnings found by the commission to have been collected by The Ohio Bell Telephone Company were referrable to rates not collected under bond, and under the laws of Ohio probably not subject to refund.

The second reduction in the sum of $335,414 was made in the commission's order of September 6, 1934 (R., 372) for the purpose of correcting an error. The amount of the refunds finally fixed by the commission in its order of September 6, 1934 was $11,832,264 with interest from the date of payment by the respective subscriber of said excessive charges, to the date of repayment by The Ohio Bell Telephone Company.

In its order of July 9, 1934 (R., 308) the commission required The Ohio Bell Telephone Company to show cause why its future rates should not be reduced.

The Supreme Court of Ohio approved the findings and

affirmed the orders of the commission in their entirety (R., 533) and the opinion of that court is reported in *131 O. S., 539* to *602*, and in *3 N. E. (2d), 475* to *501*.

In its order of July 9, 1934 the commission required the company to show cause why its future rates should not be reduced. But in none of the orders heretofore referred to did the commission fix rates to be charged in the future. The commission's failure to fix rates for the future was included in appellant's assignments of error filed in this court (Assignments of Error 9) and in its brief appellant calls the attention of the court to that fact. (Appellant's brief, p. 2.)

In this connection, this court will be interested in knowing that on the twenty-ninth day of January, 1937 in this same proceeding, the commission, with the consent and acquiescence of the company, issued its finding and order fixing the rates of the appellant to be charged for the future beginning April 1, 1937. The rates so fixed being a reduction of the contested rates in an amount of approximately $1,912,000 per annum. This finding and order of the commission is not yet reported.

ERRORS COMPLAINED OF AND ISSUES PRESENTED.

Under the heading "Specification of Assigned Errors Intended to be Urged", at page 16 of its brief (Appellant's brief, p. 16), appellant recites that there are fifteen assignments of error (R., 18) and that all errors assigned are relied upon except Assignment 9 and 10, Subdivision (b) of Assignment 12, Subdivisions (d) and (e) of Assignment 13 and Assignment 14.

The points now relied upon by appellant do not include many of the issues presented by the appellant in the Supreme Court of Ohio, including many of the questions on the valuation of the appellant's property, a substantial number of the questions raised in connection with the appellant's license contract with American Telephone & Telegraph Company, the question of the fair rate of return, the question of depreciation of telephone instruments, the question of existing depreciation or percent condition and the commission's attempt to reduce future rates.

The points relied upon by the appellant in this court are:

(1) Under the topic of valuation as of June 30, 1925—the four items of omitted land, going value, Western Electric prices and costs and reproduction costs.

(2) The method adopted by the commission, and approved by the Supreme Court of Ohio, of determining the

fair value of appellant's property for the years 1926 to 1933 inclusive.

(3) The amount allowed by the commission and approved by the Supreme Court of Ohio as appellant's expense of depreciation for each of the years 1926 to 1933.

(4) The action of the commission, approved by the Supreme Court of Ohio, in disallowing certain payments made by appellant to American Telephone and Telegraph Company for the period of 1925 to 1932.

(5) The method of allocating the refunds ordered by the commission to the various municipalities involved.

In this brief, appellee has confined itself, in the main, to answering the arguments presented by the appellant in its brief. Many additional arguments might have been advanced by appellee to sustain its position, but in the interest of economy of time, space and money, it has, in the main refrained from discussing any element not raised in the brief of appellant.

SUMMARY OF ARGUMENT.

I.

VALUATION.

(Infra, pp. 24 to 75.)

The value of the company's property fixed by the commission as of June 30, 1925, and for the succeeding years, including 1933, represents the fair and just value of the property of the company for rate-making purposes.

THE "DATE CERTAIN".

(Infra, p. 24.)

In every rate case a definite date must be selected as a basis for the valuation of the company's property for rate-making purposes. *(Ohio General Code, Sec. 499-9.)* This date, commonly called the "date certain", in the present case was June 30, 1925.

THE COMMISSION'S TENTATIVE REPRODUCTION VALUE AS OF JUNE 30, 1925.

(Infra, p. 25.)

The commission's tentative value as of June 30, 1925, of all the company's property was $104,282,735. The tentative value of the intrastate property was $101,346,634. The tentative value fixed by the commission is subject to protest and hearing thereon after which the final value is fixed by the commission.

THE COMMISSION'S FINAL VALUE AS OF JUNE 30, 1925.

(Infra, p. 27.)

The commission's final value as of June 30, 1925, of all the company's property was $96,422,276. The final value of the intrastate property was $93,707,488.

For the purpose of ascertaining the fair value of the company's property as of June 30, 1925, the commission

considered the thousands of pages of testimony introduced in this case, together with the thousands of exhibits submitted. Upon the basis of this evidence the commission placed a value upon all of the separate items making up the property of the company devoted to the service of the public in the rendition of telephone service to its subscribers.

ITEMS OF COMMISSION'S FINAL VALUE NOW CHALLENGED BY APPELLANT.

(Infra, p. 27.)

Many of the items making up the final value of appellant's property as of June 30, 1925 and challenged by the appellant in the court below, are not now being urged by it in this court. Included in the items so omitted are the following: Construction work in progress, undistributed construction costs, the distributing system, working capital, right of way and existing depreciation or percent condition.

The only questions as to the valuation of appellant's property as of June 30, 1925 now presented for this court's consideration in appellant's brief are: (1) omitted land, (2) going value, (3) Western Electric prices and (4) cost and reproduction cost.

Omitted Land. (Infra, p. 28.)

For the item of land, Account 211, the commission allowed the sum of $3,256,854 this being the full amount claimed by the company less only the value of land not

used and useful. When land purchased by the company for future use actually became used and useful it was included in the valuation and allowed by the commission.

This procedure followed by the commission was in accordance with the provisions of the Ohio Statutes *(General Code, Secs. 499-8, 499-9, 614-20, 614-23)* and with the decisions of the Supreme Court of Ohio and of this court.

Logan Gas Company v. Public Utilities Commission of Ohio, 121 O. S., 507;
Columbus Gas & Fuel Company v. Public Utilities Commission of Ohio, 127 O. S., 109, 117, 122;
Columbus Gas & Fuel Company v. Public Utilities Commission of Ohio, 292 U. S., 398, 78 L. Ed., 1327;
Dayton Power & Light Company v. Public Utilities Commission of Ohio, 127 O. S., 137;
Dayton Power & Light Company v. Public Utilities Commission of Ohio, 292 U. S., 290, 78 L. Ed., 1267.

Going Value. (Infra, p. 31.)

Where evidence that reproduction cost new less depreciation, using current prices as of a date certain, plus liberal general overheads, working capital and material and supplies is given due consideration in connection with other competent evidence in arriving at fair value, it is manifest that under the law, going concern value has been given all the consideration it deserves and no separate allowance therefor is necessary. This principle has long been recognized as the rule of the Supreme Court of Ohio and it has been fully recognized and applied by this court

in its most recent decisions. It is particularly applicable where, as here, the evidence on going value is purely conjectural and speculative and based on elaborate calculations as to the theoretical cost of attaching business.

Cincinnati & Suburban Bell Telephone Company v. Public Utilities Commission of Ohio, 113 O. S., 259;
The Hardin-Wyandot Lighting Company v. Public Utilities Commission, 118 O. S., 592, 603;
Portsmouth Gas Company v. Public Utilities Commission, 119 O. S., 24;
Columbus Gas & Fuel Company v. Public Utilities Commission, 127 O. S., 109;
City of Houston v. Southwestern Bell Telephone Company, 259 U. S., 318;
Galveston Electric Company v. Galveston, 258 U. S., 388;
Des Moines Gas Company v. City of Des Moines, 238 U. S., 153;
Dayton Power & Light Company v. Public Utilities Commission of Ohio, 292 U. S., 290, 308; 78 L. Ed., 1267, 1280;
Columbus Gas & Fuel Company v. Public Utilities Commission of Ohio, 292 U. S., 398; 78 L. Ed., 1327.
St. Joseph Stock Yards Co. v. United States, 298 U. S., 38; 80 L. Ed., 1033.

Western Electric Prices. (Infra, p. 43.)

Where the commission, in determining the reproduction cost of the property of The Ohio Bell Telephone Company as of June 30, 1925, allowed the full amount contended for by the company as the cost of equipment purchased from Western Electric, with the exception of the increase in price of 10.2% claimed by Western Electric

and effective November 1, 1930, the commission has allowed a fair and reasonable price to the company for its purchases from Western Electric and its finding has the approval of the highest courts in the land.

Smith v. Illinois Bell Telephone Company, 282 U. S., 133, 75 L. Ed., 255;
Illinois Bell Telephone Company v. Gilbert, 3 F. Supp., 595;
Lindheimer v. Illinois Bell Telephone Company, 292 U. S., 151; 78 L. Ed., 1182.

Cost and Reproduction Cost. (Infra, p. 47.)

The commission in its valuation gave full consideration to both reproduction costs new and the actual cost of the property of the appellant.

Existing Depreciation or Percent Condition. (Infra, p. 49.)

The company now apparently does not challenge the finding of the commission, approved by the court below, to the effect that the property of the company used and useful in rendering telephone service in the state of Ohio was in a percent condition as of the "date certain" of approximately 87%. Inasmuch as this finding of the commission was fully sustained by the testimony adduced and was further substantiated by an examination of the financial history of the company and is not now challenged by the company in its brief it can be assumed to be correct.

THE COMMISSION'S FINDING OF VALUE FOR 1926 AND SUBSEQUENT YEARS FOR RATE-MAKING PURPOSES.

(Infra, p. 50.)

Upon the basis of the thousands of pages of testimony and the thousands of exhibits which were introduced into the record of this case, the commission determined that the fair present value of the intrastate property of The Ohio Bell Telephone Company devoted to the public service as of June 30, 1925, was $93,707,488. This finding of the commission was made on January 16, 1934, approximately nine years after the "date certain" of June 30, 1925. It was therefore necessary for the commission to ascertain by some appropriate method the fair value of the company's property for each of the years succeeding 1925. Using the valuation of June 30, 1925, as the basic value, the commission computed the value for each succeeding year by applying price indices for telephone property to that basic value for each year involved, and then added to the result so obtained the full net additions made by the company in each year at 100% in order that the fair value in each of the years might be accurately portrayed. The method followed by the commission was a fair and reasonable one, was based upon evidence and was the only practicable method by which the fair value of the company's property for the years succeeding 1925 could be ascertained.

II.

OPERATING EXPENSES.

(Infra, pp. 75 to 127.)

The importance of determining the proper amount to be allowed as operating expenses has been recognized by this court in the recent case of *Lindheimer v. Illinois Bell Telephone Company*, 292 U. S., 151, 54 S. Ct., 658, 78 L. Ed., 1182 (1934). With the exception of the amounts claimed by the company for the expense of depreciation, license contract costs and Western Electric purchases chargeable to expense, the commission allowed without question all of the operating expenses contended for by the company.

DEPRECIATION.

(Infra, p. 77.)

The rates of depreciation prescribed by the commission are equitable and sufficient to permit the company to make normal replacements of property due to wear and tear, obsolescence and inadequacy and to maintain the physical plant in a proper state of efficiency.

LICENSE CONTRACT PAYMENTS.

(Infra, p. 110.)

An administrative body such as The Public Utilities Commission of Ohio, in passing upon the reasonableness of the operating expenses of a public utility operating under its jurisdiction, is not bound to accept as conclusive the amounts allegedly paid by such public utility to its parent company for services presumably rendered by the parent company to the operating company under a license contract made between these affiliated concerns but such an administrative body may inquire into the value and the propriety of such services and upon the basis of the evidence introduced and in the exercise of its administrative discretion, it may determine the fair and reasonable value of the services and the propriety thereof, and this determination made upon proper evidence should not be disturbed by any reviewing court.

Western Distributing Company v. Public Service Commission of the State of Kansas, 285 U. S., 119, 75 L. Ed., 655;

Smith v. Illinois Bell Telephone Company, 282 U. S., 133, 75 L. Ed., 255;

Dayton Power & Light Company v. Public Utilities Commission of Ohio, 292 U. S., 290, 78 L. Ed., 1267;

Columbus Gas & Fuel Company v. Public Utilities Commission of Ohio, 292 U. S., 398; 78 L. Ed., 1327.

Field Occupied by The American Telephone and Telegraph Company. (Infra, p. 115.)

It is important to a complete understanding of this case to comprehend the varied activities of the American Telephone and Telegraph Company and to understand the wide field occupied by it.

III.

THE CONTENTION OF THE COMPANY AS TO "REFUNDS IMPROPERLY ORDERED."

(Infra, pp. 128 to 139.)

The claim of the company that the commission has erroneously ordered it to refund to the telephone subscribers of Ohio entitled thereto the sum of $11,832,264 is predicated upon the objection of the company to the method used by the commission in allocating this refund to the various municipalities concerned, it being the contention of the company that in order that these refunds might be properly ascertained the commission must of necessity conduct a separate valuation proceeding for each of the communities involved and upon the basis of this valuation proceeding allocate to each community the amount of the refunds to which it is entitled. While the commission recognized that this was one method of allocating the refunds to the various communities the commission was of the opinion that it was not the only method and that to have applied it would have resulted in intolerable de-

lays and would have resulted in the scrapping of substantially all of the work that had been done over a period of ten years under the theory of a state-wide telephone investigation. The commission, therefore, adopted another method of allocation which was perfectly sound in principle and is not injurious to the company. With but one exception the method adopted by the commission has met with the approval of the municipalities concerned and the company should not now be heard to complain because it feels that a better method might have been chosen.

IV.

APPELLANT'S FINANCIAL EXPERIENCE.

(Infra, pp. 140 to 146.)

Upon the basis of the commission's findings the appellant's book surplus at November 30, 1933 would be $10,682,929 *after* the payment of that portion of its excessive earnings found by the commission to be refundable to its subscribers in the amount of $11,832,264 while at the same time its reserve for depreciation would have been $14,652,468 instead of $21,999,901 as shown by the company's books. In other words, at November 30, 1933 the appellant should have had a book surplus of $22,515,193 with a reserve for accrued depreciation of $14,652,468. That the appellant has seen fit to deplete its surplus by excessive credits to its depreciation reserve in addition to excessive payments to American Telephone & Telegraph Company and Western Electric Company should not mislead any careful student of the facts.

ARGUMENT.

I.

VALUATION.

The value of the company's property fixed by the commission as of June 30, 1925, and for the succeeding years, including 1933, represents the fair and just value of the property of the company for rate-making purposes.

The starting point in this case is the valuation of the company's property devoted to the public service for the purpose of determining the rate base and a large part of the volumnious record adduced in this case is concerned with that question.

THE DATE CERTAIN.

In every rate case a definite date must be selected as a basis for the valuation of the company's property for rate-making purpose. This date, commonly called the "date certain", in the present case was June 30, 1925.

It is recognized that for valuation purposes a definite date must be selected as the date of the valuation. This date, known as the "date certain", was June 30, 1925. (R., 126; 166.)

Under the Ohio statutes a valuation fixed by the commission in a rate case is subject to protest *(Sec. 499-12, Ohio General Code)*. The original valuation fixed by the commission is known as the "tentative value". If no

protest is filed this tentative value becomes the "final value". If a protest is filed the commission is required to hear the protest and thereafter to fix a final value which may be either the tentative value or a modification thereof.

THE COMMISSION'S TENTATIVE REPRODUCTION VALUE AS OF JUNE 30, 1925.

The commission's tentative value as of June 30, 1925, of all the company's property was $104,282,735. The tentative value of the intrastate property was $101,346,634.

In this case the tentative value of all the company's property as of June 30, 1925 (including both interstate and intrastate property), was fixed by the commission in its order of January 10, 1931, at $104,282,735 (R., 145). No tentative value as to the purely intrastate property was fixed but by applying the intrastate percentage arrived at in the final valuation (97.18448%) to the tentative value of $104,282,735 produces, for comparative purposes, a tentative intrastate valuation of $101,346,634 (R., 243).

Protests were filed to this tentative valuation on behalf of both the company and the state (R., 158). These protests were duly heard and thereafter the commission in its order of the sixteenth day of January, 1934, fixed a final valuation for all of the company's property of $96,422,276 and for the purely intrastate property of $93,707,488 (R., 195).

Counsel for the company in their brief evidence some

surprise at the action of the commission in reducing the amount of the tentative intrastate valuation by the sum of $7,639,146. This reduction in the tentative value was made up of the following items:

(a) A reduction in the sum of $316,090 in Account No. 207, right of way;

(b) By disallowing the sum of $3,490,905 as going concern value;

(c) A reduction in the amount allowed for working capital, including materials and supplies, in the sum of $535,970;

(d) A reduction in the sum of $3,296,181 in undistributed construction costs.

Inasmuch as the very purpose of *Section 499 12, Ohio General Code,* is to provide for a hearing on the tentative value and the adjustment thereof in such manner as the commission may feel is necessary, it is difficult to understand why a modification of the tentative value should occasion such grave concern as to the propriety of the commission's action. (Cf. *St. Joseph Stock Yards Company v. United States of America,* 298 U. S., 38; 80 L. Ed., 1033.)

It is significant that in spite of the company's criticism of the commission's action in reducing the final value as hereinbefore described, the only item in the reduction of which the appellant complains in this court, is the item of going value.

THE COMMISSION'S FINAL VALUE AS OF JUNE 30, 1925.

The commission's final value as of June 30, 1925, of all the company's property was $96,422,276. The final value of the intrastate property was $93,707,488.

For the purpose of ascertaining the fair value of the company's property as of June 30, 1925, the commission considered the thousands of pages of testimony introduced in this case together with the thousands of exhibits submitted. Upon the basis of this evidence, and in the exercise of its proper judgment, the commission placed a value upon all of the separate items making up the property of the company devoted to the service of the public in the rendition of telephone service to its subscribers. (R., 231, 234.) Its finding in this respect was affirmed by the Supreme Court of Ohio (R., 533, 568-571).

ITEMS OF COMMISSION'S FINAL VALUE NOW CHALLENGED BY APPELLANT.

Many of the items making up the final value of appellant's property as of June 30, 1925, and challenged by the appellant in the court below, are not now urged by it in this court. Included in the items so omitted are: construction work in progress; undistributed construction costs; the distributing system; working capital; right of way and existing depreciation or per cent condition. This abandonment by the appellant of subtantially all of

the individual items going to make up the final value of its property as of June 30, 1925, is a tacit admission of the correctness of the final value fixed by the commission and affirmed in the court below.

The only questions relating to the valuation of appellant's property as of June 30, 1925, presented in appellant's brief for this court's consideration are: (1) omitted land (2) going value (3) Western Electric prices and (4) cost and reproduction cost. We shall discuss them in the order named.

(1) Omitted Land.

When the value placed upon land—Account 211, grants to the company the full amount claimed by it less only the value of land not yet used and useful the item has been given all the value to which it is entitled under the law.

The following evidence as to the valuation of this account was introduced in this case:

Reproduction Values at June 30, 1925.

Commission's final valuation	$3,256,854	(R.,231)
Books	2,693,406	(R., 7395)
Valuations submitted by the company:		
Williams	3,943,467	(R., 8159)
Sloan	3,943,467	(R., 7258)
Valuations submitted by state:		
Hagenah	3,943,467	(R., 6742A)
Allensworth	3,943,467	(R., 6245)
Tentative valuation	3,256,854	(R., 143)

It will be observed that Witnesses Williams, Sloan and Hagenah agreed upon $3,943,467 as the reproduction value of the land owned by the company. That amount is $686,613 greater than the commission's tentative and final valuation and is occasioned by the fact that the commission excluded certain parcels of land included in the valuation as not being used and useful at the date certain. The commission based its refusal to include the value of such real estate in the rate base upon the theory that the statutes of Ohio *(G. C., Sections 499-8, 499-9, 614-20, 614-23, etc.)* are explicit in that only used and useful property shall be included in the rate base and that lands purchased for future use must be excluded, but that their value may be considered to enhance the rate base as of the date when they actually became used and useful. This procedure was followed by the commission and when and as the particular parcels of land in question actually were put in use by the company they were then included in the rate base of this account (R., 160; 233). By this procedure, the sum of $586,959 was added to the valuation of the company's property by the commission after the date certain of June 30, 1925. In spite of the fact that substantially all of this property did not become used and useful in serving the public until from two to four years after the date certain (R., 233) the appellant insists that the commission should have included it in the valuation as of the date certain. The procedure followed by the commission finds additional justification in the fact that some of the parcels never became useful (Appendix C, Commis-

sion Finding, R., 233). Certainly, the company cannot criticise the commission for the attitude which it has taken in respect to this account.

Logan Gas Company v. Public Utilities Commission of Ohio, 121 O. S., 507;
Columbus Gas & Fuel Company v. Public Utilities Commission of Ohio, 127 O. S., 109, 117, 122;
Columbus Gas & Fuel Company v. Public Utilities Commission of Ohio, 292 U. S., 398, 78 L. Ed., 1327;
Dayton Power & Light Company v. Public Utilities Commission of Ohio, 127 O. S., 137;
Dayton Power & Light Company v. Public Utilities Commission of Ohio, 292 U. S., 290, 78 L. Ed., 1267.

The cost of this item, as shown on the books of the company, is $2,693,406, including parcels which were excluded by the commission as of the "date certain", and the value of these parcels is $686,613. Consequently, the book value of the land in use as of the "date certain" was $2,006,793. The amount allowed by the commission as of the "date certain" was $3,256,854, or $1,250,061 in excess of the actual cost of the property to the company.

(2) Going Value.

Where evidence of reproduction cost new less depreciation, using current prices as of a date certain, plus liberal general overheads, working capital and materials and supplies is given due consideration in connection with other competent evidence in arriving at fair value, it is manifest that under the law, going concern value has been given all the consideration it deserves and no separate allowance therefor is necessary.

The company through its witnesses Schneider (Exhibit 3, R., 7121), Williams (Exhibit 11, R., 8161) and Sloan (Exhibit A-1, R., 7258) contended for a going concern value of from $20,768,158 to $22,493,551. In other words, to a property with a fair value of $93,707,488 as of the date certain the company attributed a going concern value in excess of $20,000,000. The commission refused to allow this fanciful claim of the company for a wholly intangible item, in the following language:

> "Considering that our valuation is of a plant in actual and successful operation, and that we have made (post) what we regard as ample allowance for direct and undistributed overhead construction costs and that no specific costs have been established that are not covered by such allowance, and considering also that many items testified to are 'too obviously conjectural' and giving weight to the definite declarations of both the Supreme Court of the United States and of the state of Ohio, we have concluded that the testimony offered does not justify a separate allowance of going concern value, either as such or as 'cost of establishing business'. We therefore now hold that the amount, tentatively allowed

by the commission, of $3,592,040.00 as going concern value should be eliminated as a separate item." (Commission opinion, R., 173.)

That the commission's action in refusing to make a separate allowance for going concern value was fully sustained by the facts and the law is not subject to serious dispute.

It should be remembered that all of the items included in "the cost of establishing business", as testified to by the company's witnesses were in the nature of operating expenses, and had they actually been incurred by the company they would have been charged to operating expenses on its books (R., 1335-37). Many similar items of expense were so incurred and charged to operating expense by the company during the period under review and all of those charges have been allowed in full by the commission as operating expenses. As a matter of fact, these expenses are of a constantly recurring nature and are specifically provided for and classified as operating expenses in the uniform system of accounts for telephone companies as prescribed by the Interstate Commerce Commission, adopted by the Ohio commission, and followed by the company. It should be noted that all manner of repairs, wages, supplies, traffic, commercial and general expenses are provided for under Accounts Nos. 601 to 676, inclusive, and particularly that in addition to the detailed classifications and definitions for each account wherein various elements defined by the company's witnesses as cost of establishing business would be charged,

specific provisions is made in particular accounts for such elements as follows:

Account 627—Operators' schooling.
Account 642—Advertising.
Account 643—Canvassing.
Account 644—Sublicensee relations.
Account 646—Revenue accounting.
Account 649—Directory expense.
(R., 7023/34.)

It should be further noted that at December 31, 1924 there were prepayments of $250,510 as shown for Account 128 under Wood Exhibit No. 1 (R., 8171) which under the company's accounting methods could be charged to expenses during subsequent periods and which were allowed in full by the commission as and when such charges to expenses were made.

The commission could not in justice permit the company to earn a return upon the capitalization of an expense, which expense itself has been claimed and allowed in the determination of a fair return. To permit such a claim would result in requiring the telephone patrons not only to pay the entire amount of these expenses but also to pay a return upon the capitalized value thereof.

It is true that none of the witnesses either for the company or the state included any specific element for going concern value in any direct or indirect overhead allowances but it is also true that having completed the theoretical reconstruction of the property according to the program contemplated and the method of valuation adopted as of June 30, 1925, everything would be in readiness for the immediate commencement of operations

not later than the morning of July 1, 1925. All subscribers would be connected with the switchboards, their telephones would have been tested, inspected and ready for use, the supervisory employees provided for in the overhead allowances would have engaged the necessary personnel and would have purchased the required supplies, buildings and offices would be fully equipped, directories would be issued and paid for, out of working capital, the cost being carried in Account No. 132—prepaid directory expenses for distribution and absorption in Expense Account No. 649—directory expenses during the period of use per Interstate Commerce Commission regulations, and, in fact, the whole picture would be throbbing with activity and expectancy pending arrival of the actual minute of time when telephone service would begin. It is inconceivable that it would cost the company millions of dollars in addition to the millions already expended as allowed by the commission, to give such a picture the breath of life that would set it in motion, when the only requirement to transmute this fully equipped enterprise into a going concern would be the lapse of time measured by the tick of a clock at twelve o'clock midnight on June 30, 1925.

We should like to call the court's attention to a further fact and that is that all of the reserve facilities, provisions and plans made for future growth have been included and allowed in the inventory and appraisal as though they were plant actually in service. Such a plant has been considered useful if not actually used, and having been thus actually included in the value of physical

property no further consideration should be given to it in a separate allowance for going concern value. The examples of these reserve facilities and their presence throughout the plant are numerous but a few of them may be suggested as follows:

1. Underground conduit containing, for example, six ducts of which only two or three are actually used and the others held in reserve for future use, has been allowed in full.

2. Aerial and underground cable of larger capacity than present requirements demand, contain hundreds of extra cable pairs to care for future growth and all of these have been allowed in full.

3. Practically all switchboards and other equipment of central offices have a much greater capacity than present requirements demand and could accommodate a sizeable growth in subscribers without further capital investment, and all of these facilities with their extra capacity have been allowed in full.

4. Poles carrying only one or two cross-arms supporting less than the maximum number of wire circuits, are in many instances larger or heavier than actually required and these have been allowed in full with their additional capacity to accommodate considerable expansion in the distributing system.

5. Practically all of the newer buildings and many of the old, contain more space than would be actually required and have been built with the idea in view of future expansion and the value of these with their extra facilities have been allowed in full.

The commission did not criticize the company for these provisions for the future, but, in fact, commended it for its foresighted policy in making reasonable provision for future growth and has not hesitated to allow the full value of such provisions as contained in the inventory and appraisal, but the commission did not feel justified in again making an allowance in the form of going concern value to cover this element or to compensate the company an additional amount for having exercised its judgment in providing such facilities.

Company's Method of Arriving at a Theoretical Going Value Has Been Repeatedly Disapproved by This Court.

The contention of the company for going concern value was based primarily upon the introduction of testimony relating to the cost of establishing business—a method which has been expressly disapproved by this court (*Columbus Gas & Fuel Company v. Public Utilities Commission of Ohio*, 292 U. S., 397). It lays great stress upon the evidence introduced in this record with respect to going value and in its brief (Appellant's Brief, p. 82) asserts that going value " • • • was established by the evidence of every witness testifying on the subject."

An examination of the evidence so strongly relied upon by the appellant is indeed interesting. It discloses that the company produced three witnesses who testified as to going value. Witness Schneider arrived at a going concern value, denominated by him as the cost of establishing business, of $20,76[illegible],158. (R., 1366;

Schneider Ex. 3, R. 7121). He described the method by which this amount was determined in the following language:

> "To ascertain or determine the amount or cost of establishing business included in that figure, I have subtracted the plant additions during the quarter-year period, the sum being $126,912,935, plus the interest during construction amount of $7,481,264, leaving what in my judgment is the cost of establishing business amount of $20,768,158." (R. 1366.)

Schneider's testimony clearly indicates that he did not use any actual expenditures made by the appellant as the basis for arriving at his conclusions on going concern value (R., 1336), and it further indicated that such expenditures when made had been charged by the company to their proper accounts (R. 1337). In reaching his conclusions as to going value Schneider relied to a very large degree upon the theoretical cost of attaching business (R. 1339), a method criticized by this court in the case of *The Columbus Gas and Fuel Company v. Public Utilities Commission of Ohio*, supra.

Williams, who likewise testified on behalf of the company as to going value (R. 1369), stated that he had made no separate study of his own as to going concern value but that he had given thought and study to the costs for going concern value or the cost of establishing business as presented by Schneider and that from this study he had reached the conclusion that Schneider's fig-

ure of $20,768,158 was correct. (Williams Ex. 11, R. 8161.)

Sloan who also testified on behalf of the company likewise used the cost of attaching business theory in determining the cost of establishing business of The Ohio Bell Telephone Company at the date certain. (R. 1759.) Sloan admitted that he had not tried to make a complete determination of going value (R. 1760), but in spite of that fact, his figure for this item was modestly placed at $22,493,351. (R. 1772.)

Special reliance is placed by the appellant on the testimony of Hagenah, the only state witness who testified as to going value. For that reason, some of Hagenah's statements as to going value are of particular interest. We quote but one of them:

> "Going concern value like the value of any item of property or class of property must necessarily be a matter of judgment. No one can prove the amount of it. * * *" (R. 2080.)

Hagenah like the other witnesses who testified on this subject then proceeded in an attempt to establish a going concern value by using the cost of attaching business theory (R. 2081) along with other theories. The fact is that the going concern value testified to in this case was determined in a purely speculative fashion and upon estimates based upon pure assumptions in a manner recently disapproved by this court in the case of *St. Joseph Stockyards Company v. United States of America*, 298 U. S. 38, 80 L. Ed., 1033.

It is upon this type of testimony that the company

bases its claim for an allowance in excess of $20,000,000 for going concern value. The fallacy of such reasoning we believe is self-evident. The company would have us disregard the fact that trained employees are just as much physically in existence as of a date certain as the necessary material such as "telephone lines," etc. When such employees are hired their degree of training is evidenced by their salary. Under the company's theory they would capitalize the cost of such theoretical training thus making the rate-payer pay a return on such salary. After we have literally reconstructed the plant just as it is, the company desires to have us assume that there would be a certain amount of "trying out" and adjusting to produce the most satisfactory degree of service. Again they seek to capitalize something which has been paid for as an operating expense or which is non-existent.

It is clear that where fair value is fixed upon evidence such as was before the commission no additional separate allowance for going concern value is allowable as a matter of law and were this not so, as it is, the company has wholly failed to sustain the burden of establishing any separate element of going concern value by evidence either competent or of probative value. The law is well settled, both under the decisions of the Supreme Court of Ohio and of this court, that where the property of a utility is valued, not as junk or property lacking utility, but as a going plant in successful operation, the element of going value has been given all the consideration which

it deserves, and no additional separate allowance for going concern value is permissible.

Cincinnati & Suburban Bell Telephone Company v. Public Utilities Commission of Ohio, 113 O. S., 259;
The Hardin-Wyandot Lighting Company v. Public Utilities Commission, 118 O. S., 592, 603;
Portsmouth Gas Company v. Public Utilities Commission, 119 O. S., 24;
Columbus Gas & Fuel Company v. Public Utilities Commission, 127 O. S., 109;
City of Houston v. Southwestern Bell Telephone Company, 259 U. S., 318;
Galveston Electric Company v. Galveston, 258 U. S., 388;
Des Moines Gas Company v. City of Des Moines, 238 U. S., 153.

The basic fallacy in the appellant's position is that it attempts to add a separate allowance for going concern value not to evidence of fair value of property considered as junk, disconnected units or without business attached, without earnings or prospects of earnings but to a fair value for a plant in full operation with customers attached and earning money. It must be manifest to the most naive that if the plant of the appellant or any plant were valued as junk, or as property unassembled, or as property without customers attached, without established business, and without earnings, such a value would inevitably be only a fraction of the reproduction cost new less accrued depreciation as estimated in this and other utility rate cases. Manifestly, such a plant would be so lacking in utility that not even the most ardent representative of utility interests could contend that its fair value was anything approaching reproduction cost new of the physical property plus general overheads, materials and supplies, and working capital.

The Decisions of This Court Recognize That No Separate Allowance For Going Value is Either Necessary or Proper in a Case Such as This.

The fact manifestly is that where due consideration is given to reproduction cost new at current prices, less accrued depreciation, plus general overheads, materials and supplies, and working capital, in connection with any other competent testimony, in arriving at the fair present value for rate-making purposes, that utility property has been valued as a going concern with every element of going concern value given all the weight it deserves, and that no separate and additional allowance for going concern value may be made without a manifest duplication. The more recent decisions of this court recognize this fact.

Los Angeles Gas & Electric Corporation v. Railroad Commission of the State of California, 289 U. S., 287, 77 L. Ed., 1180;

Dayton Power & Light Company v. Public Utilities Commission of Ohio, 292 U. S., 290, 308, 78 L. Ed., 1267, 1280;

Columbus Gas and Fuel Company v. Public Utilities Commission of Ohio, 292 U. S., 398, 78 L. Ed., 1327;

St. Joseph Stock Yards Co. v. United States of America, 298 U. S., 38, 80 L. Ed., 1033;

In *Columbus Gas and Fuel Co. v. Public Utilities Commission of Ohio,* supra, this court in paragraph 11 of the syllabus held as follows:

> "11. The exclusion of the going value of a gas company's business as an item entering into the rate base is not improper where such value was reflected in other items and particularly in the appraisal of the physical assets as part of an assembled whole."

In the discussion of this topic the court says *(290 U. S., 411, 78 L. Ed., 1335)*:

> "Objection is made also as to the disallowance of a going value for the affiliated companies. Going value was excluded both by court and by commission as an item of property to be separately appraised and separately reported. The record justifies a holding that it was reflected in the other items and particularly in the appraisal of the physical assets as part of an assembled whole. Cf. *Hardin-Wyandot Lighting Co. v. Public Utilities Commission*, 118 Ohio St., 592, 603, 162 N. E., 262. This, we think, was adequate. • • •
>
> "The going value of the Ohio Fuel Gas Company was placed by the appellant's witness at a figure so high ($12,000,000) as to be excessive almost on its face, and the impression of exaggeration is confirmed when the appraisal as a whole is resolved into its elements. • • •
>
> "Other experts, who reject the factor of interest unearned during the period of development, build their estimates of going value upon the cost of attaching new customers to the business, a cost not taken from the books, but merely presumed or estimated at widely variant amounts. So far as such expenses had been actually incurred by any affiliated company, they had already been included as part of the cost of operation. So far as value had been added above the moneys thus expended, there was not even approximate precision in measuring its amount. The burden of building up patronage may be negligible where there is little competition with any other producer or with other kinds of fuel. *Charleston v. Public Serv. Commission*, 110 W. Va., 245, 159 S. E., 38, supra."

The weakness of appellant's contention with respect to going value is brought into bold relief by the complaint

of the appellant expressed time and again in its brief, that the commission in arriving at its tentative value, had allowed the amount of $3,592,040 for going value and that this sum was not allowed in the final value (Cf. *St. Joseph's Stock Yard Co. v. United States*, supra). We have previously explained the nature of the tentative value fixed by the commission. We have pointed out that it is subject to protest after which the final value is found. It is difficult to understand why the company who contends that the evidence established a going concern value of more than twenty million dollars can now argue so earnestly for but three and one-half million dollars for this same item.

The willingness of the company to accept as a proper allowance for going value so small a sum in the face of their original claims challenges the sincerity of their assertions.

(3) Western Electric Prices.

Where the commission in determining the reproduction cost of the property of The Ohio Bell Telephone Company as of June 30, 1925, allowed the full amount contended for by the company as the cost of equipment purchased from Western Electric, with the exception of the increase in price of 10.2% claimed by Western Electric and effective November 1, 1930, the commission has allowed a fair and reasonable price to the company for its purchases from Western Electric and its finding has the approval of the highest courts in the land.

The Ohio Bell Telephone Company purchases substantially all of its telephone equipment from the West-

ern Electric Company. It is, of course, a well known fact that the Western Electric Company and The Ohio Bell Telephone Company are wholly owned subsidiaries of the American Telephone & Telegraph Company and that any transactions between such affiliated subsidiaries are necessarily subjected to a closer scrutiny than would be incurred in the case of non-affiliated corporations.

In determining the reproduction cost of the telephone property of The Ohio Bell Telephone Company one of the very large items, of course, is the cost of equipment to that company. Since substantially all of that equipment is purchased from the Western Electric Company the fairness of the prices charged by Western Electric becomes a matter of great importance. After a careful examination of this whole situation the commission determined that it would not disturb its former findings as to the costs of purchases from Western Electric in determining the present reproduction cost of The Ohio Bell Telephone Company as of June 30, 1925, nor would it disturb the cost of purchases from Western Electric subsequent to that date except as to the price increase of 10.2% as of November 1, 1930. The commission was of the opinion, however, that the price increase effective November 1, 1930, should be disallowed. The company complains of this procedure.

In the decision of *Smith v. Illinois Bell Telephone Company*, 282 U. S., 133, 75 L. Ed., 255, decided December 1, 1930, it was held that:

> "Findings as to the profit made by an affiliated manufacturing company on the sale of equipment to

> a telephone company, and as to the extent to which such profit figures in estimates upon which is predicated the claim that telephone rates fixed by a public utilities commission are confiscatory, are necessary to the determination of such claim."

and that case was remanded to the statutory court for further proceedings in order that the necessary findings might be made upon that particular point.

Pursuant to the mandate of this court in the foregoing case the statutory court in the case of *Illinois Bell Telephone Company v. Gilbert*, 3 Fed. Supp., 595, decided April 29, 1933, found the earnings and profits of the Western Electric Company sales to its Bell customers for each of the years 1916 to 1932, inclusive. These findings were that the earnings on the average investment, less the amount of depreciation reserve account, for the year 1925 was 12.9%; 1926, 10.6%; 1927, 13.6%; 1928, 15.8%; 1929, 11.7%; 1930, 5.8%; 1931, 5.6% and for the year 1932 there was a loss of 3.3%. In considering the very question that is here presented, namely, the disallowance of the price increase of 10.2 claimed by Western Electric and effective November 1, 1930, the statutory court at paragraph 21 of its findings held as follows:

> "In determining reasonable operating expenses to be allowed to plaintiff after November 1, 1930, there should be a reduction of 10 per cent from the prices charged by Western Electric Company on purchases made by plaintiff attributable to maintenance and other expense accounts, and this deduction has been made in determining the amount allowed in these findings on account of plaintiff's operating expenses."

When this decision of the statutory court was in turn presented to this court for review in *Lindheimer v. Illinois Bell Telephone Company*, 292 U. S., 151, 78 L. Ed., 1182, this finding of the statutory court was not disturbed. This court commenting upon this particular subject in the following language:

> "• • • Considering the fact that ninety-nine per cent of the stock of appellee is owned by the American Telephone & Telegraph Company which also owns substantially the same proportion of the stock of the Western Electric Company, we directed that there should be further examination of the purchases made by appellee from the Western Electric Company and of the payments made by appellee to the American Company. As it appeared that the Western Electric Company, through the organization and control of the American Company, was virtually the manufacturing department for the Bell system, we directed specific findings to be made as to the net earnings of the Western Electric Company in that department and as to the extent to which, if at all, such profit figured in the estimates upon which the charge of confiscation was predicated. • • • The court found that the equipment and supplies furnished by the Western Electric Company had been sold to appellee at fair and reasonable prices, and that the earnings of the Western Electric Company on its investment allocated to the business done with appellee, and its profits on sales, had been fair and reasonable, with the exception of an advance in prices of 10.2 per cent. effective on November 1, 1930. That advance the court disapproved, and in determining the reasonable outlays to be allowed to appellee after that date, the court made a reduction of 10 per cent. from the prices charged by the Western Electric Company. Appellee contests this reduction, and appellants object to the amounts allowed. • • •"

Upon the basis of these very recent findings of the highest courts in the land upon the same identical facts which are here presented (Stipulation Chicago case dated December 20, 1932; R., 724) we can find but little merit in the company's contention that the commission erred in refusing to consider the Western Electric price increase of November 1, 1930.

(4) Cost and Reproduction Cost.

The commission in its valuation gave full consideration to both reproduction costs new and the actual cost of the property of the appellant.

Under this heading, the appellant contends that the commission in fixing its final value as of June 30, 1925 did not give proper consideration to reproduction cost new. This contention is wholly without merit and is refuted by the very language of the commission's opinion and finding of January 16, 1934 (R., 195; 248-A). The fact is that the commission from the thousands of pages of testimony and the thousands of exhibits introduced in this record determined the reproduction value, the percent condition and the present value of the property of the appellant as of the date certain (R., 248-A). Because the sum so arrived at is not as great as the appellant contends it should be, and because it is somewhat less than the undepreciated costs carried on the books of the company, the appellant contends that the commission has not given proper consideration to reproduction costs. This argument is obviously without merit.

The fallacy of the appellant's argument is best illustrated by the fact that they have accepted the final valuation as of June 30, 1925 fixed by the commission with the exception of the items of (1) Omitted Land, (2) Going Value and (3) Western Electric Prices these being the only items on valuation now argued by the appellant in this court. Since land was allowed by the commission in the full amount claimed with the exception of those parcels not used and useful and since going value was not established by evidence either competent or of probative value and since Western Electric prices were allowed in full with the exception of the 10% price increase in 1930 it is apparent that appellant's argument as to reproduction cost is not sound.

The argument with respect to appellant's costs is even more fallacious. The books of the company disclose that at June 30, 1925, the fixed capital of the company was $98,712,030 (R., 8170) from which must be deducted the reserve for accrued depreciation amounting to $12,330,763 and reserve for amortization of $229,740 or a total of $12,560,503 and leaving a depreciated book value of $86,151,527. The present value fixed by the commission as of June 30, 1925 was $93,473,774 or $7,322,247 more than the present value as shown by the books of the company.

It is therefore apparent that the commission in fixing a value as of the date certain of $7,322,247 in excess of the depreciated book value must have given full consideration to reproduction cost.

EXISTING DEPRECIATION OR PER CENT CONDITION.

The company does not now challenge the finding of the commission, approved by the court below, to the effect that the property of the company used and useful in rendering telephone service in the state of Ohio was in a percent condition as of the "date certain" of approximately 87%. Inasmuch as this finding of the commission was fully sustained by the evidence and was substantiated by an examination of the financial history of the company and is not now challenged by the company it must be assumed to be correct.

APPELLANT'S VALUATION OFFER.

The appellant concludes its discussion of the subject of valuation with the above heading. (Appellant's Brief, p. 86.) Appellant therein states that on April 15, 1930 before the commission had fixed a tentative or final value, it offered to accept as a fair value for its intrastate property, the sum of approximately $101,000,000. The question naturally arises as to why the company would be willing to voluntarily accept a valuation on its property of more than forty million dollars less than the value testified to by its two valuation witnesses, Williams and Sloan (R., 8161; 7258). Such a proffer cannot fail to create the impression that its claim as to value expressed through its witnesses, was far in excess of what they should have been and seriously challenges the validity of the evidence submitted by the appellant.

THE COMMISSION'S FINDINGS OF VALUE FOR 1926 AND SUBSEQUENT YEARS FOR RATE-MAKING PURPOSES.

Upon the basis of the thousands of pages of testimony and the thousands of exhibits which were introduced into the record of this case, the commission determined that the fair present value of the intrastate property of The Ohio Bell Telephone Company devoted to the public service as of June 30, 1925, was $93,707,488. This finding of the commission was made on January 16, 1934, approximately nine years after the "date certain" of June 30, 1925. It was therefore necessary for the commission to ascertain by some appropriate method the fair value of the company's property for each of the years succeeding 1925. Using the valuation of June 30, 1925, as the basic value, the commission computed the value for each succeeding year by determining from evidence available to it, the fair value for each succeeding year beginning with the year 1926 and concluding with the year 1933, adding to the results so obtained for each year the net additions made by the company in the full amount thereof, so that the fair value of each of the years might be accurately portrayed. The method followed by the commission was a fair and reasonable one and was the only practicable method by which the fair value of the company's property for the years succeeding 1925 could be ascertained.

For the purpose of ascertaining the valuation of a public utility's property for rate-making purposes a "date certain" is selected as the date upon which such valuation shall be predicated and the evidence intro-

duced in the case for the purpose of determining fair value is based upon prices existing at the "date certain."

It has been pointed out heretofore that the "date certain" in this particular case was June 30, 1925, and to establish the value of the property of The Ohio Bell Telephone Company as of that date thousands of pages of oral testimony were introduced before the commission together with thousands of exhibits, all relating to the reproductive value of the company's property as of the "date certain". Upon the basis of the voluminous evidence so produced the commission found the fair present value of the intrastate portion of the property of The Ohio Bell Telephone Company for rate-making purposes as of June 30, 1925, to be $93,707,488. (R., 195.) Had this finding been made in 1925 the excessive earnings accruing to the company up to that time would have been ordered refunded to the telephone subscribers entitled thereto and the rates of the company then in effect would have been ordered reduced for the future in accordance with the commission's finding of fair value.

However, the commission, due to the tremendous volume of testimony that was introduced in this case and the many delays that were incurred and which were entirely beyond the commission's control, did not issue its finding and order in this matter until January 16, 1934, or almost nine years after the "date certain." If the commission had limited its findings to the "date certain" it would have been forced to hold that the earnings of the company under its then existing rates were excessive and the company would have been compelled to place

in effect a schedule of rates which for the succeeding years might have been unfair to it in the light of the changing value of the company's property in those years. The commission, recognizing that the company in the nine years that had intervened since the "date certain" had made many additions to its property thereby increasing the value of it, was of the opinion that by some appropriate method it should arrive at a valuation for each of the subsequent years for the purpose of ascertaining whether or not the company had earned excessive rates in the succeeding years and the amount thereof for each year involved. It, therefore, examined the evidence which had been introduced in the case as to the additions made by the company during the period subsequent to June 30, 1925, together with the retirements for the purpose of ascertaining the value of the property in each of the years succeeding June 30, 1925. Had the commission's examination stopped at this point the result would have been that to the valuation of June 30, 1925, would have been added the cost of the additions, less retirements, for each of the succeeding years and the result so arrived at would not have represented the fair value of the property for they probably would not have reflected either an increase or decrease in the basic price level of the original valuation or additions for any one year. The commission was confronted, therefore, with the problem of determining the value of the property in the succeeding years by some proper method which would be fair both to the company and its subscribers, and which at the same time would not necessitate a new valuation proceeding for each of the years involved. It should be obvious to any unbiased person that an attempt to fix the value for the succeeding years by the introduction of testimony

similar to that introduced for the purpose of determining the value as of the "date certain" was a practical impossibility and that if such a procedure were followed by any administrative commission the determination of the fair value of a public utility's property for the purpose of rate-making would never be concluded.

The commission, therefore, determined that the only practicable method of ascertaining the fair value of the company's property for each of the years succeeding 1925 was by ascertaining that value upon the basis of the evidence that was available to it for the purpose of determining the fair value of the company's property in each of the years involved, adding to the results so obtained all the net additions made by the company at 100% thereof. By this method, the following valuations of the company's intrastate property were arrived at:

Date	(1) Depreciated Book Cost	(2) Commission's Present Value	Excess Col. 1 Over Col. 2	Excess Col. 2 Over Col. 1
June 30, 1925	$ 86,591,399	$ 93,707,488		$7,116,089
June 30, 1926	95,232,903	101,767,774		6,534,871
June 30, 1927	106,542,570	111,036,522		4,493,952
June 30, 1928	119,156,193	122,417,735		3,261,542
June 30, 1929	129,549,781	135,765,576		6,215,795
June 30, 1930	140,587,783	145,683,047		5,095,264
June 30, 1931	145,530,783	145,271,663	$ 259,120	
June 30, 1932	144,658,320	133,625,655	11,032,665	
June 30, 1933	141,594,996	126,250,206	15,344,790	
Totals			$26,636,575	$32,717,513

The above analysis shows that during the eight-year period from June 30, 1925, to June 30, 1933, the present value assigned by the Commission exceeded book value by $32,717,513 during five years and was less than book value by $26,636,575 during the other three years. The net difference, $6,080,938, over a period of eight years would be the equivalent of $760,117 per year in excess of the company's actual investment in its property.

The company now insists that this method as used by the commission was erroneous; that it was denied a fair trial, and that its property has been confiscated. The finding of the commission in this connection is perhaps best expressed in the commission's own language (commission's opinion of January 16, 1934, R., 187-9). We quote, therefore, from that opinion:

"**Price Trends.**

"When we examine the condition of the company's property, both as to value and income, subsequent to June 30, 1925, we must take into consideration not only the net additions, but also changed conditions and price trends, that we may determine whether the rate, fixed at the day certain, produces a revenue sufficient to afford the company a just return for a reasonable time in the immediate future.

In the case of the *Central Kentucky Natural Gas Company, Appellant, v. Railroad Commission of Kentucky, supra,* the Supreme Court, in discussing the refusal of the court below to take into account the effect of changed conditions said:

'That restriction also necessarily excluded from consideration the profound changes in values, costs of service, consumption of commodity and reasonable return on invested capital which we judicially know took place during the period of more than five years, while the case was pending before the commission and the court.'

In numerous cases, courts have indicated that they may take judicial cognizance of the downward trend of prices during the years of the depression. We feel that the commission may likewise take notice of such fact. If we did not do so, it might well happen that a rate fixed for 1925 upon the then value of the property would subsequently be inadequate to afford a just return if the additions and betterments were

considered and price trends disregarded, but that this same rate would be sufficient over that term of years when due consideration is given to price trends decreasing the value of the property upon which the return must be earned. Sections 499-11 and 499-15 G. C., provide the method of ascertaining the facts. The commission may resort to any information available to keep itself informed of extensions and improvements and other changes in the value of the property.

We have endeavored from such sources of information as are available to correctly measure the price trends of telephone property including accounts 211 to 265, since the day certain. A study was made of the cost prices furnished by manufacturers of telephone equipment over the several years. The trend of land valuation was ascertained from examination of the tax value in communities where the company had its largest real estate holdings, confining such to urban property only. For building trends resort was had to prices indices of the Engineering News Record, a recognized magazine in the field of engineering construction. Labor trends were developed from the same sources. Resort was also had to the finding of the statutory court in the Chicago case and its study of price level of sales of the Western Electric Company. That court was there dealing with December 31, 1920, as the date certain and considered the level of that date as 100%, whereas we are dealing with a price level subsequent to June 30, 1925. The trend in price for each year as compared to the preceding years, indicated in the Chicago decision, taking the level of December 31, 1920, as 100%; was 1921,—1.7%; 1922, 1926,—8.7%; 1927,—4.9%; 1928,—10.3%; 1929,—8.6%.

In the Chicago case, the court disallowed the advance of 10.2% in Western Electric prices as of November 1, 1930, but held that plaintiff was entitled to a maintenance of the 1930 price level during

the years 1930, 1931 and 1932. In harmony with the decision of this court, we hold that the price for 1931 and 1932 for Western Electric should not be increased.

It would appear that the Chicago court in fixing its price trend considered only the price trend of the Western Electric purchases, probably on the assumption that it was a correct index of the price trend of all telephone property. We, however, have thought it pertinent, as above indicated, to secure price trends of telephone properties from the sources we have indicated in addition to the price trend of the Western Electric which we have applied to equipment sold by that company. We are conscious that there may be some errors in this computation of price trends, but we feel that we are well within the line of safety in that we have considered only price trends as affecting telephone property, and that such trends are largely built upon the prices of the Western Electric which have not declined to the extent of general commodity prices.

Taking the date certain, June 30, 1925, as 100% and considering the added equipment for each year as 100% as of the year of installation, our examination develops a composite trend applicable to the entire property, exclusive of right of way and working capital, as of the beginning of the respective years and related to the preceding year as follows: 1926, 98.73%; 1927, 96.97%; 1928, 99.20%; 1929, 101.45%; 1930, 95.65%; 1931, 93.95%; 1932, 88.71%, and 1933, 102.96%. The figures supporting these percentages are too numerous to set out in detail but the manner in which the percentages have been applied to the value of the property for each year is shown in Appendix 'B'.

An interesting discussion of price trends will be found *In re Chesapeake and Potomac Telephone Company*, decided by The Public Service Commission of Maryland, November 28, 1933. This com-

mission considered numerous indices in arriving at its conclusion as to the price trend for the telephone company and exhibits a graph of various price trends and the composite trend arrived at.

When we plot the price trends found by us and compare our graph with that of the Maryland commission and the graph of the price trends by the Chesapeake Company, we find that all are practically parallel until 1930. After that date our graph parallels that of the Maryland commission, but indicates values practically an average of those claimed by the telephone company and found by the Maryland commission.

The graph exhibited in the Maryland commission's decision does not cover the year 1933. During 1933, we find an upward trend in both as to labor and material but a downward trend as to land value, the average of all property indicating a slight upward trend. (See graph, Appendix 'N'.)''

The Contention of Appellant That the Values Fixed by the Commission For 1926 and Thereafter Were Not Based on Evidence.

The appellant rests its entire case on this subject upon the contention that the values fixed by the commission for 1926 and the succeeding years were based on information withheld from appellant and not offered or introduced in evidence. It strenuously endeavors to apply the principles laid down by this court with respect to the use of price trends in fixing values in the case of *West v. Chesapeake & Potomac Telephone Company of Baltimore City*, 295 U. S., 662; 79 L. Ed., 1640 to this case, but a careful examination of the facts of the two cases will indicate that they have essential points of difference,

and that the law enunciated by this court in the West Case is not applicable to the case at bar. In the first place, no reproductive valuation upon the basis of an inventory and appraisal as of the date certain was made in the West case. In the second place, the price indices relied upon in the West case were not based upon price indices of telephone property, but were arrived at by a complex application of commodity indices. In this case the commission specifically said "• • • we have considered only price trends as affecting telephone property, and that such trends are largely built upon the prices of Western Electric which have not declined to the extent of general commodity prices." (R., 188.) Surely the appellant when it refers to 'secret information' (appellant's brief p. 16) and 'information withheld from appellant' (appellant's brief p. 25) does not refer to the prices of Western Electric upon which the commission says it largely built its price trends, (R., 188) for it must be apparent even to the uninitiated that the findings of the statutory court in the Chicago case in this connection were a matter of public record and that a large part of the record in that case was stipulated into the record of this case. (R., 724.) In the third place, the company in the West case introduced testimony both before the commission and in the federal court as to its reproductive value in all of the years involved. No such evidence was introduced by the company or proferred by the company in this case.

It must constantly be remembered that the commission, in the case at bar, in determining the value of the

company's property for the years succeeding 1925, attempted to measure that value by applying price indices of telephone property to the value determined by it from actual testimony as of the date certain plus net additions. (R., 187-9.) It must also be remembered that the commission had before it for that purpose the voluminous record produced in this case plus that portion of the record in the Chicago case included by stipulation. (R., 724.) in which there is evidence as to the value of telephone property for the period involved. It should also be borne in mind that the commission had available to it the finding of the statutory court in the Chicago case and its study of the price level of sales of the Western Electric Company and that the commission based its findings of value "largely • • • upon the prices of Western Electric which have not declined to the extent of general commodity prices". (R., 188.)

Appellant argues that it first learned of the commission's use of price trends in fixing values for the years 1926 and thereafter, when the order of January 16, 1934, was announced (appellant's brief, p. 26). Surely the appellant knew throughout this proceeding that some such basis of determining the fair value of its property for the years in question would have to be used by the commission if this case were ever to be concluded. *(Cf. Northwest Bell Telephone Company v. Nebraska State Railway Commission*, 297 U. S. 471; 80 L. Ed. 810.)

Appellant also agrues that after the commission had issued its finding and order of January 16, 1934, fixing the value of its property as of the date certain and for

each year thereafter through the year 1933, it requested of the commission an opportunity to examine, analyze, explain and rebut the information considered by the commission in arriving at its findings, (R., 256-273; 312-383) but the appellant at no time proferred any testimony to show that the results obtained by the commission were erroneous or that they resulted in the confiscation of the company's property. In other words, the commission having issued its finding and order adversely to the company, upon the basis of the thousands of pages of testimony and thousands of exhibits introduced in this record, and upon the basis of information that the commission as a regulatory body must be conceded to have available to it the company without offering to show wherein the results obtained were in error insisted upon the opportunity to examine, analyze, explain and rebut the findings of the administrative body.

The burden of sustaining the increased rates sought by the company was upon the company throughout this proceeding. It failed to sustain that burden.

The company lays great stress upon the assertion that the findings of the commission were not based upon evidence in the record and in fact were based upon secret information; they quote from the dissenting opinion of the chairman of the commission to the effect that the cost trends applied did not reflect telephone construction costs, and that they were derived from trade magazines and other publications, not in evidence. This statement in the dissenting opinion is at variance with the findings of the majority of the commission, which specifically

said that the cost trends applied were derived from telephone property and specifically sets forth the sources of its information. (R., 187-9.) Cf. *Baltimore and Ohio Railroad Company et al. v. United States of America et al.*, 298 U. S., 349; 80 L. Ed., 1209.

That there was evidence in the record upon which the commission could predicate its findings as to value for the years 1926 and thereafter, we believe, is amply demonstrated.

The evidence as to Western Electric prices for almost the same period of time was fully set forth in the Chicago case with which this court is familiar. *(Lindheimer v. Illinois Bell Telephone Company,* supra.) A large portion of that evidence was stipulated into the record of this case. (R., 724.) The findings of the statutory court with respect to Western Electric Company prices for telephone apparatus *(Illinois Bell Telephone Company v. Gilbert*, 3 Fed. Supp., 595) was a matter of public record known both to the commission and the company. (Appellant's brief, page 26.) That it was upon this evidence that the commission largely built its prices for the telephone property of the appellant for the years 1926 through 1933 is best illustrated by the commission's own language:

> "It would appear that the Chicago court in fixing its price trend considered only the price trend of Western Electric purchases, probably on the assumption that it was a correct index of the price trend of all telephone property. We, however, have thought it pertinent, as above indicated, to secure price trends of telephone properties from the sources we have indicated in addition to the price trend of the West-

ern Electric which we have applied to equipment sold by that company. We are conscious that there may be some errors in this computation of price trends, but we feel we are well within the line of safety in that we have considered only price trends as affecting telephone property, and that such trends are largely built upon the prices of Western Electric which have not declined to the extent of general commodity prices."

And the soundness of the commission's findings can be mathematically demonstrated by comparing the price trend percentages thus arrived at with those found in the Chicago case.

COMPARISON PRICE TRENDS ADOPTED BY STATUTORY COURT IN CHICAGO CASE AND THOSE ADOPTED BY OHIO COMMISSION.

(Chicago Case.) "It appears from the evidence that taking the price level of December 31, 1920, as one hundred percent, the annual changes in price level of sales by Western Electric Company to plaintiff, were as follows: 1921, —1.7%; 1922, —10.7%; 1923, +0.2%; 1924, —5.6%; 1925, —1.1%; 1926, —8.7%; 1927, —4.9%; 1928, —10.3%; 1929, —8.6%.

"The price level at the end of 1929, was 58.3% of that of December 31, 1920. . . ." Illinois Bell Telephone Company v. Gilbert, 3 Fed. Supp., 595.

Application of Above Price Levels in Illinois Bell Case.

Period Applied	*Net change during each period*	*% Current Yr to 12-31-20*
December 31, 1920—Basic Date		100.0%
Year 1921	— 1.7% of 100.0% = — 1.7%	98.3%
Year 1922	—10.7% of 98.3% = —10.5%	87.8%
Year 1923	+ 0.2% of 87.8% = + 0.2%	88.0%
Year 1924	— 5.6% of 88.0% = — 5.0%	83.0%
Year 1925	— 1.1% of 83.0% = — 0.9%	82.1%
Year 1926	— 8.7% of 82.1% = — 7.2%	74.9%
Year 1927	— 4.9% of 74.9% = — 3.7%	71.2%
Year 1928	—10.3% of 71.2% = — 7.4%	63.8%
Year 1929	— 8.6% of 63.8% = — 5.5%	58.3%

Application of Price Levels in Illinois Bell Case to Corresponding Periods Covered by Ohio Bell Case.

Period Covered	*Net change during each period*	*% Current Yr. to 6-30-25*
June 30, 1925—Basic Date		100.0%
Year 1926	— 8.7% of 100.0% = — 8.7%	91.3%
Year 1927	— 4.9% of 91.3% = — 4.6%	86.8%
Year 1928	—10.3% of 86.8% = — 8.9%	77.9%
Year 1929	— 8.6% of 77.9% = — 6.7%	71.2%

Per Cent Each Current Period to Preceeding Current Period Based on Illinois Bell Case, Used by Commission in Ohio Bell Case.

						Excess of Ohio Bell Over Illinois Bell Price Levels
			6 Mos.	1925	100.00%	
91.3%	: 100.0% =	91.3%	Year	1926	98.73%	7.43%
86.8%	: 91.3% =	95.1%	Year	1927	96.97%	1.87%
77.9%	: 86.8% =	89.7%	Year	1928	99.20%	9.50%
71.2%	: 77.9% =	91.4%	Year	1929	101.45%	10.05%
			Year	1930	95.65%	
			Year	1931	93.95%	
			Year	1932	88.71%	
			Year	1933	102.96%	

But appellant objects that other "undisclosed information" was used by the commission and refers to the statement made by the commission to the effect that "a study was made of the cost prices furnished by manufacturers of telephone equipment over the several years". (R., 188.)

Of course the largest manufacturer of telephone equipment is Western Electric. In 1932 Edgar S. Bloom was president of Western Electric and had been since 1926. (R., 3941; 5017.) In addition he was a director or officer in most of the affiliated Bell enterprises. (R., 5017.) For that reason his testimony as to the prices of telephone

equipment is particularly pertinent. Mr. Bloom made a study of Western Electric costs and prices for the period from 1921-30 and stated that he had selected that period as one in which prices were declining. (R., 3977.) In a letter to telephone company presidents (Ex. X433, R., 9249-10) written on August 26, 1927, Mr. Bloom in his capacity as president of Western Electric called attention to the fact that prices on approximately 50 classes of telephone apparatus would be reduced effective September 1, 1927. The per cent price reduction ranging from 3 to 28%. Mr. Bloom pointed out that price reductions made during the years 1926 and 1927 (the first two years after the date certain in this case) would aggregate $20,000,000, annually, on the present volume of purchases. He pointed out that additional reductions in the cost of installation work had been accomplished and that through the cooperation of the operating companies other costs had been appreciably reduced. He gave his opinion that these savings would total $6,000,000 in addition to the $20,000,000 already referred to and would all told amount to a reduction of 13% on annual sales of Western Electric to the Bell companies. (R., 9250.)

On October 17, 1930, Mr. Bloom wrote another letter. (Ex. X434, R., 9250.) This communication was addressed to Mr. Frederick H. Reid, president Mountain States Telephone and Telegraph Company, Denver, Colorado. In this letter Mr. Bloom stated that for the years 1926-1929 many important reductions had been made in prices for the products and charges for the services of Western Electric to the associated companies. He stated that

"price reductions made since the beginning of 1926 have resulted in an annual saving to the associated companies of approximately $100,000,000 based on their present volume of purchases. This means that, at January 1, 1926, prices, the associated companies would have paid over 25% more for their 1930 purchases than the actual billing rendered." After pointing out that the depression would necessitate some increase in prices Mr. Bloom said "our present price level on telephone apparatus and equipment is about 72% of the January 1, 1926, level. With the readjustments effective November 1, 1930, the level will be about 79%, or 21% lower than at January 1, 1926."

Now Mr. Bloom's testimony was neither "secret" nor "undisclosed". As president of the largest manufacturer of telephone equipment in the world he was well qualified to testify on the prices of that equipment and he testified to reductions in cost prices of telephone equipment which if strictly applied by the commission would have resulted in lower valuations for appellants property for the years 1926-1933 than those fixed by the commission. For example Mr. Bloom stated that for the years 1926 and 1927 prices were reduced 13%—yet for 1926 the commission's valuation was 98.7% of the final value at June 30, 1925 (Appellant's Brief, page 8) and for 1927 it was 95.7% of the final value at June 30, 1925. (Appellant's Brief, page 8.) Mr. Bloom pointed out further reductions in 1928, 1929 and 1930 so that in October of 1930 prices were only 72% of the January 1, 1926 level. Yet the commission's value for 1928 was 95% of

the 1925 valuation, for 1929 it was 96.3% of the 1925 valuation, and for 1930 it was 92.2% of the 1925 valuation.

Furthermore in the 8½ years from the date certain through 1933 net additions to the property of the company totaling $68,743,044 (Wood Ex. 2, R., 8172) were allowed and throughout the 8½ year period these net additions were treated as being in 100 per cent condition and nothing was deducted for the accrued depreciation which necessarily would be present. This is but another instance of the liberality of the commission.

Bloom was not the only witness that introduced evidence into the record of this case as to the cost of telephone equipment in the period involved. Richard H. Gregory, comptroller of Western Electric, also introduced evidence on this subject. The following data is taken from Exhibit X-13A, Statement B, R., 8966—

EXHIBIT X-13A.

Statement B.

Estimated Effect of Price Changes on Apparatus and Equipment Sold to Bell Telephone Company, 1921-1930.

	Tel. Apparatus Sales at Preceding Year's Dec. 31st Prices	Effect of Price Change Made Each Year (Annual Basis)	% Price Change (Annual Basis)	Price Level At End of Year
12/31/20	.....	.....	.....	100.0
1921	$70,015,000	(—$1,200,000)	(— 1.7)	98.3
1922	82,010,000	(— 8,800,000)	(—10.7)	87.8
1923	86,450,000	+ 200,000	+ 0.2	88.0
1924	109,670,000	(— 6,100,000)	(— 5.6)	83.0
1925	97,690,000	(— 1,100,000)	(— 1.1)	82.1
1926	107,870,000	(— 9,400,000)	(— 8.7)	75.0
1927	101,740,000	(— 5,000,000)	(— 4.9)	71.3
1928	112,240,000	(—11,500,000)	(—10.3)	64.0
1929	145,980,000	(—12,500,000)	(— 8.6)	58.5
1930	140,690,000	+14,400,000	+10.2	64.4

		Effect in 1930 of 1930 Changes	Average Increase Actually Effective in 1930	Average 1930 Price Level
1930 Sales at Average 1930 Prices	$143,040,000	$2,350,000	+1.7	59.5
1930 Sales at Average 1930 Prices	.....	.....	.....	$143,040,000
1930 Sales at 12/31/30 Prices	.....	143,040,000	.....	240,605,000
		595		

Cumulative effect of Price Changes since 12/31/30 in 1930 Volume 97,565,000

RAL :ID, 1/14/32

Note: The above is a complete copy of a table (Statement B) included in the supporting data and working papers made available on January 15 in response to my letter of January 11 to Mr. Gregory in reference to Statement A bearing the same title but on a non-cumulative basis.

EEH

Numerous other exhibits reflecting the trend of prices on telephone equipment are found in the record. A few of these include Exhibit X-14, R., 8967—Price Indices of Copper and Lead, wholesale prices, (R., 8968) Metal and Metal Products and Building Materials (R., 8969); Exhibit D-81, R., 8930, Cost of Copper Bar and Lead Purchased by Manufacturing Department 1918-1931; Exhibit D-1, R., 8948D—Prices of Transmitters, Receivers and Induction Coils sold to Bell from January 1, 1926, to December 31, 1930. These and other exhibits all reflected the change in price levels after 1925 to a far greater degree than found by the commission. And yet appellant contends that the findings of the commission as to value during the period from 1926-1933 was based on undisclosed information and that its property

is being confiscated without at any time showing wherein the values fixed by the commission are in error.

At page 30 of its brief appellant states that its "evidence was rejected". This cannot be so for none was offered. What appellant means is that having spent ten years on a state wide inquiry for the purpose of ascertaining the justness of its rates it wanted to go back and go through the whole procedure again on the basis of its separate exchanges on the theory that it had insisted upon offering separate testimony as to each exchange while going along all the while in the state wide case and introducing its testimony on that basis. The inference in appellant's brief is that it had offered evidence as to value for the years 1926-1933 and that this evidence was rejected. This is not the fact.

That the company's property is not being confiscated is self-evident. That it has not been deprived of its property without due process is apparent. For twelve years it prosecuted its case before the commission. The record so made consists of thousands of pages of testimony and thousands of exhibits relating to the fair value of the property of the company devoted to the furnishing of telephone service in the state of Ohio and to other pertinent matters concerning the justness of the rates to be charged for that service. On the basis of that evidence, the commission reached its decision as to the rates properly chargeable by the appellant for its telephone service over the period involved. Its conclusions are supported by evidence and did not result in confiscation of appellant's property.

The fact is that the primary attack made by the appellant on the findings of the commission is directed at the method used by the commission rather than at the results obtained. The burden of appellant's complaint as to lack of due process resting in the allegation that the commission did not advise it as to the precise weight given to the various phases of the evidence with respect to the value of appellant's property for the years 1926 to 1933 inclusive, and did not inform the appellant as to the mental operations by which its decision was reached. This court, as recently as May 18, 1936, has said with respect to the interstate commerce commission:

> "***There is no requirement that the commission specify the weight given to any item of evidence or fact, or disclose mental operations by which its decisions are reached. Useful precision in respect of either would be impossible. And it would be futile upon the record to attempt definitely to ascertain the weight assigned to any fact or argument in prescribing the divisions. ***" *Baltimore & Ohio Railroad Company et al. v. United States of America et al.*, 298 U. S. 349, 359; 80 L. Ed., 1209, 1219.

Any careful examination of the facts will show that in fixing the value of appellant's property for the period from 1926 through 1933 that the commission acted neither capriciously or arbitrarily but upon the basis of the evidence available to it and if the results so obtained by the commission are checked against the evidence available and in the light of judicially recognizable facts, the accuracy of the commission's conclusions is further emphasized.

It has previously been pointed out that the commission had available to it in this case the findings of the Statutory Court *(Illinois Bell Telephone Company v. Gilbert supra)* in respect of Western Electric prices for telephone apparatus in addition to other evidence relating to the value of telephone property during the period involved. It has also been established by the language of the commission's own opinion that it relied largely upon the price levels so developed in connection with Western Electric for the purpose of computing the price levels applicable to the property of the appellant and the results so obtained were checked against other information available to the commission for the purpose of determining their accuracy. It has been demonstrated that the price levels applied by the commission to the property of the appellant were considerably higher than the price levels applied by the Statutory Court in the *Gilbert case supra*, with respect to this same type of property. In spite of all this, the appellant contends that it has been deprived of its property without due process of law because it disapproves of the method followed by the commission.

This court and other courts have fully recognized the difficulties encountered by administrative commissions in the fixing of values for vast utility properties year by year in a period of fluctuating price levels and this court and other courts have recognized that the values of such properties cannot be obtained with absolute accuracy and that some reasonable estimate in many cases will be necessary. In *Illinois Bell Telephone Company v. Gil-*

bert et al, supra, the Statutory Court was concerned with the valuation of the property of the Illinois Bell Telephone Company over a period comparable to the one involved in this case. In that case, the fair value of the company's property for the years, 1923 through 1930, was determined by the court upon the basis of an estimate made by the company's engineers as to the cost of reproducing the company's property. These estimates were based in a large degree on Western Electric prices. By this method, definite values were allocated to the property for each of the years, 1923 through 1930. However, no such definite findings of value were made for the years, 1931 and 1932. In commenting upon the valuation for the two years, 1931 and 1932 the court said (p. 601):

> "The valuation of plaintiff's property for 1931 and 1932 presents some difficulties which are not present in the other years. We are obliged to take notice of the general decline of the property values which has accompanied the present period of business stagnation. For this reason we cannot take the reproduction estimates based on the cost of labor and material stated in the record at their face. We have fixed values therefore for 1931 and 1932 which in our opinion give due consideration to the element of the present general decline in values."

By this method, the Statutory Court found that the value of the Illinois Bell Telephone Company's property in the case there involved for 1931 was $197,500,000 or $7,500,000 less than the value fixed for the same property for the year 1930. And for 1932 the court found that the value of the property involved was $185,000,000 or $20,000,000 less than the value fixed for the year 1930.

This finding of the Statutory Court met with the approval of this court when that case came to this court for review in *Lindheimer v. Illinois Bell Telephone Company*, 292 U. S. 150; 78 L. Ed., 1182, this court commenting on the findings of the District Court in the following language: *(292 U. S., 158; 78 L. Ed., 1188.)*

> "The District Court found that the method adopted by appellee's witness in ascertaining the cost of reproduction new was reliable and that appellee's estimates were substantially correct. The court encountered difficulties in making its valuations for the years, 1931 and 1932. It took notice of the general fall in values which had accompanied the depression in business. And for that reason, the court fixed values for 1931 and 1932 which in its opinion 'gave due consideration to the element of the present decline' ".

In *Central Kentucky Natural Gas Company v. Railroad Commission of Kentucky*, 290 U. S. 264; 78 L. Ed., 307, this court in paragraph 9 of the syllabus said:

> "Judicial notice may be taken of changes in values, cost of service, consumption of commodities and reasonable return on invested capital which have taken place during the period while a case was pending before the utilities commission and the court."

In that case the period involved was from December 31, 1926 to September, 1932, a period almost identical with the one involved in this case and it is to this period that the court refers when it discusses: *(290 U. S., 274; 78 L. Ed., 314.)*

> "• • • the profound changes in values, costs of service, consumption of commodities and reasonable return on invested capital. • • • "

This principle so announced was a reiteration of the principle previously followed by this court in *Atchison, Topeka, & Santa Fe Railway Company et al. v. United States,* 284 U. S., 248; 76 L. Ed., 273, and subsequently approved in *Dayton Power & Light Company v. Public Utilities Commission of Ohio,* 292 U. S., 290; 78 L. Ed., 1267.

Too much emphasis cannot be placed upon the fact that in the case at bar the attack of the appellant is centered upon the method used by the commission in arriving at the value of appellant's property for the years, 1926 through 1933. Little is said with respect to the results obtained and in this connection the decisions of this court in several recent cases are pertinent.

In *Los Angeles Gas & Electric Corporation v. Railroad Commission of the State of California,* 289 U. S., 287; 77 L. Ed., 1180, this court in paragraph 1 of the syllabus says:

> "In a suit involving the validity of rates fixed by a state public service commission, the Supreme Court of the United States does not sit as a board of revision, but to enforce constitutional rights, and is not concerned either with the method used in reaching the determination except as it may have a definite bearing on the validity of the result reached, or in the determination itself, so long as constitutional limitations are not transgressed."

And in its opinion in this case, the court in discussing this particular question says *(289 U. S., 304; 77 L. Ed., 1192):*

> "• • • We have emphasized the distinctive function of the court. We do not sit as a board of re-

vision, but to enforce constitutional rights. * * * The legislative discretion implied in the ratemaking power necessarily extends to the entire legislative process, embracing the method used in reaching the legislative determination as well as that determination itself. We are not concerned with either, so long as constitutional limitations are not transgressed. * * * "

This principle was restated in the recent case of *St. Joseph Stock Yards Company v. United States of America*, 298 U. S., 38; 80 L. Ed., 1033, wherein this court said *(298 U. S., 51; 80 L. Ed., 1041)*:

" * * * The court does not sit as a board of revision to substitute its judgment for that of the legislature or its agents as to matters within the province of either. * * * When the Legislature itself acts within the broad field of Legislative discretion, its determinations are conclusive. When the Legislature appoints an agent to act within the sphere of legislative authority, it may endow the agent with power to make findings of fact which are conclusive, provided the requirements of due process which are specially applicable to such an agency are met, as in according a fair hearing and acting upon evidence and not arbitrarily. * * * In such cases, the judicial inquiry into the facts goes no further than to ascertain whether there is evidence to support the findings, and the question of the weight of the evidence in determining issues of fact lies with the legislative agency acting within its statutory authority."

And in *Baltimore & Ohio Railroad Company v. United States of America*, 298 U. S., 349; 80 L. Ed., 1209, this

court held that the findings of the Interstate Commerce Commission: *(298 U. S., 362; 80 L. Ed., 1221.)*

> " • • • Based on evidence and its determination as to the significance to pertinent facts found are conclusive. • • • "

In conclusion, it must constantly be borne in mind that while the appellant vigorously contends that the finding of the commission with respect to the value of its property is confiscatory, the appellant has offered no evidence to establish that fact, and that the established rule of this court is that one claiming that a rate established by a public authority is confiscatory has the burden of showing it to be such, and that this court will not interfere with the exercise of the rate making power unless confiscation is clearly established. *St. Joseph Stock Yards Company v. United States of America, supra; Dayton Power and Light Company v. Public Utilities Commission of Ohio, supra.*

II.

OPERATING EXPENSES.

The importance of determining the proper amount to be allowed as operating expenses has been recognized by this court in the recent case of *Lindheimer v. Illinois Bell Telephone Company*, 292 U. S., 151, 78 L. Ed., 1182 (1934), where it held in paragraph 3 of the syllabus:

> "3. Charges to operating expenses may be as important as valuations of property in determining

whether a public service commission's order establishing rates for telephone service is confiscatory."

Discussing this topic in the opinion, Mr. Chief Justice Hughes speaking for the court says (p. 164):

> "Operating expenses. In determining the effect of these reductions, and what amounts would still be available to the company for net return, we come to the questions raised by the company's charges to operating expenses. Charges to operating expenses may be as important as valuations of property. Thus, excessive charges of $1,500,000 to operating expenses would be the equivalent of 6% on $25,000,000 in a rate base. In this instance, against the reductions which the rate in suit would have effected, are the considerable sums which would be added to the amounts available for return by the adjustments in operating expense made by the District Court • • •".

With the exception of the amounts claimed by the company for the expense of depreciation, license contracts costs and Western Electric purchases chargeable to expense, the commission allowed without question all of the operating expenses contended for by the company. The subject of Western Electric prices has been heretofore discussed in this brief at pages 43-47, supra. We shall therefore turn our attention to the other two items wherein differences existed in the operating expenses as contended for by the company and as allowed by the commission.

DEPRECIATION.

The rates of depreciation prescribed by the commission are equitable and sufficient to permit the company to make normal replacements of property due to wear and tear, obsolescence and inadequacy and to maintain the physical plant in a high state of efficiency.

Before discussing the company's brief in regard to depreciation, it is perhaps appropriate to state definitely the ruling of the commission with respect to this item. It found (R., 203) that "• • • a composite rate of 4% of the depreciable property is a fair and just allowance to be made annually for depreciation expense, and it is our conclusion and finding that said rate be fixed and allowed in this case to be computed on the present value of the depreciable property as of the date certain, and for years subsequent to the year 1925 to be computed upon the present value of said property as of the date certain plus net additions to the depreciable property • • •."

COMMISSION DURING ITS STUDY OF DEPRECIATION HAD TWELVE AND ONE-FOURTH YEARS OF COMPANY'S REPLACEMENT EXPERIENCE BEFORE IT.

At the time the commission determined the depreciation rate (1934) it had in evidence a great mass of data submited by appellant dealing with plant costs, additions, replacements, salvage recovery, depreciation charged each year beginning with the organization of the

company in 1921—in all a period of twelve and one-fourth years. Its problem was to fix a rate beginning with the date certain (June 30, 1925). Obviously it was in the unique position of being able to test the reasonableness of the charges actually made during the period under review. It was not forced, as are rate-fixing tribunals in most cases, to accept highly speculative and conjectural opinions of engineers and alleged experts as to the factors of wear and tear, obsolescence and inadequacy. It had facts to examine and did not resort to speculation. It proceeded upon the principle stated in *West Ohio Gas Company v. Public Utilities Commission of Ohio* (294 U. S., 79, 82, 79 L. Ed., 773, 776) that prophecy cannot be resorted to when proof is available. In other words, the commission in 1933 was assured that the depreciation rate prescribed would have been adequate to provide for the replacement of units abandoned since June 30, 1925, and, in addition, enable the company to maintain an adequate reserve for the retirement of property still in service.

ACCOUNTING METHODS OF PREDECESSOR COMPANIES NOT UNIFORM BUT ASSETS TAKEN OVER BY OHIO BELL TELEPHONE COMPANY AT BOOK VALUE.

One of the facts of fundamental importance in this entire case is that The Ohio Bell Telephone Company was organized and began business in 1921 not as a new enterprise with new capital facilities but as a consolidation

of several telephone utilities in all types of condition. Some were very old with property badly depreciated. Some operated competitively and were atracted to the consolidation by the possibilities of a unified service with higher rates and lower costs of operation. The details of the history of the organization of the present company are to be found in Hagenah Exhibit 1 (R., pp. 6541-6552). In this exhibit it is ascertained that, regardless of age, The Ohio Bell Telephone Company recorded these properties in its accounting records at the book values as shown by the records of the companies effecting the consolidation.

In Wood Exhibit 18 (R., page 8190-D) is found a statement of the reserves for depreciation and amortization taken over by The Ohio Bell Telephone Company at the time the various properties were acquired. From this study it will be noted that on September 21, 1921, the date of the formation of the present company, the total reserves amounted to $6,219,829.18 and the depreciable properties acquired amounted to $69,070,159.72. These figures would tend to show an initial reserve of 9.01% or a "per cent condition" of 90.99%, an absurdity as established by company witnesses hereinafter referred to. Between September 21, 1921 and June 30, 1925 the following properties were taken over at net cost with no depreciation reserves (Wood Exhibit 18, R., p. 8190-D):

Sandusky Home Telephone Company	$124,920.74
Springfield-Xenia Telephone Company	565,183.51
Franklin County Telephone Company	316,687.77
Montgomery County Telephone Company	85,761.98

Tuscarawas County Telephone Company	127,180.87
Upper Sandusky County Telephone Company	43,257.17
American Telephone & Telegraph Company	262,794.00

Obviously, the effect of such an accounting policy was to record these properties at 100% new, and to distort the per cent condition of the plant investment.

To accomplish the purposes of the consolidation vast sums were required and large quantities of old, obsolete and duplicating property had to be scrapped or abandoned. That the company experienced these abnormal replacements is clearly shown in a subsequent analysis made of data incorporated in the record.

COMMISSION OBLIGATED TO ANALYZE DEPRECIATION AND REPLACEMENT ENTRIES SINCE FORMATION OF COMPANY.

The cardinal principle upon which the commission based its study of depreciation was that the original capital in a public utility enterprise is to be furnished by its investors and, after this initial investment, the utility is permitted to charge annually as an operating expense an amount which measures the decline in value *during the year* attributable to wear and tear, obsolescence and inadequacy. (*Lindheimer v. Illinois Bell Telephone Company*, 292 U. S., 151, 78 L. Ed., 1182.) In principle, the distinction between the obligation of the investor and the charge against the patron of the utility is a clear one. In practice, it is frequently difficult in its application.

In this case, the commission, on account of the nature of the organization of the company, was required to make an exhaustive study of its history since 1921 to ascertain whether excessive depreciation had been charged against operating expenses in order to absorb the abnormal retirements during its program of unifying and rebuilding. It could not discharge its duty by merely accepting, without question, the company's costs of property retired. In its brief (page 39-41) appellant criticizes the commission for not allowing a depreciation rate which would have enabled the company to recover all of its retirements between 1925 and 1933. This argument would seem to be predicated upon the assumption that a rate-fixing body is merely to check upon the arithmetical accuracy of a utility's figures. Under this theory, the commission should have no interest in the extent to which the company was overcapitalized at the outset. Neither would it have a right to inquire as to the amount of depreciation which actually took place in previous years which was not assessed against the operations of those years. Such a concept of the functions of a rate-fixing body has been clearly disapproved by this court. (*St. Joseph Stockyards Company v. United States*, 298 U. S., 38, 65; 80 L. Ed., 1033, 1048.)

The purpose of the periodic charge for depreciation is to provide for the inescapable retirement of physical property. The only real test of a depreciation rate can be made by reviewing replacement experiences over a period of years to determine whether the amounts set aside annually have been reasonable for this purpose.

Appellant states (Appellant's Brief, p. 41) that the commission adopted the so-called "retirement method" in arriving at a depreciation rate. The inference apparently is that the commission was confused in its concept of the depreciation allowance and that it proceeded on the theory that the cost of property retired less salvage during a particular period should be allowed as a depreciation charge—exactly this amount and no more or less. In the commission's opinion (R., pp. 199, 200), it left no doubt as to its understanding of the relation between retirements and the annual charge:

> "The balance in the reserve on the date certain represents past accumulations for depreciation after deducting the actual retirements from year to year. These accumulations had been made by annual charges to operating expenses, i.e., by annual segregations of the revenues paid by subscribers for service received. Each year's reservation represents the company's estimate of the depreciation of its property in that year in serving subscribers, and the net accumulations in the reserve show what payments by subscribers set aside for this purpose are not yet needed, in the company's judgment, for physical retirement of property. In other words, the balance in the reserve shows the accumulated amount set aside to replace depreciated property in the future which customers have paid for in advance of writing the property out of the property and plant accounts".

What the commission did was to study retirements of the past in order to gauge the requirements of the future. The rates fixed were arrived at in accordance with the above principle as a basis.

ACCOUNTING REGULATIONS REQUIRE DEPRECIATION EXPENSE TO BE DISTRIBUTED EVENLY OVER LIFE OF PROPERTY.

The court's attention is invited to the instructions of the Interstate Commerce Commission with reference to depreciation of plant equipment. These instructions have been adopted by the Ohio commission. (Ohio Bell Telephone Company Accounting Circular No. 8, R., p. 7022.) Section (4) provides that "the rate of depreciation should be fixed so as to distribute *evenly* through the life of depreciating property the burden of extraordinary repairs and the cost of capital consumed in operations during a given month or year, and should be based upon the average life of the units comprised in the respective classes of property". In Section (6) it is stated that "Account 413—realized depreciation not covered by reserves is provided in the *corporate surplus or deficit Account* for charges for realized depreciation on tangible fixed capital retired, when such depreciation accrued prior to the establishment of Account 102—reserve for accrued depreciation Cr., *or has not been provided for by credits to that account*". (Italics ours.)

These regulations, not challenged by appellant as conflicting with sound accounting principles, require that the net cost of capital consumed in operations be prorated over the entire life and only those replacement costs can be charged against the depreciation reserve which have been previously credited to the reserve through the periodic charges to depreciation expense. All replacement costs not contemplated by such credits to the reserve are, by these regulations, to be charged against surplus which measures the profits of prior years reinvested in the enterprise.

COMMISSION FOUND RESERVE FOR DEPRECIATION AT SEPTEMBER 21, 1921, TO BE INADEQUATE AND ABNORMAL REPLACEMENTS OF $14,849,007 MADE POSSIBLE BY EXCESSIVE CREDITS TO DEPRECIATION RESERVE.

The commission, in attempting to establish a fair and reasonable depreciation rate, obviously, was forced to analyze the entries which had been made by the company in its depreciation reserve from the time of its organization in 1921 down to 1933. It had to ascertain the extent to which replacement losses had been financed from the depreciation reserves existing at the time of its organization and from those additions to the reserve made during the twelve and one-fourth years of its operation. In Table I the summary of the commission's findings with

respect to the adequacy of the depreciation reserve at the date of the company's organization, September 21, 1921, is found. Looking first at the period from September 21, 1921 to December 31, 1921, the cost of the plant retired (Column C) was $454,052, from which the company recovered $235,599 as salvage (Column D), showing a net realized depreciation of $218,453 (Column E).

TABLE I
THE OHIO BELL TELEPHONE COMPANY
REALIZED DEPRECIATION NOT COVERED BY RESERVES

Period	Depreciation Accrued Since 9-21-21 Period to Date A	B	Amount of Realized Depreciation: Original Cost of Plant Retired C	Salvage Value Recovered D	Net Realized Depreciation E	Covered by New Reserve Since 9-21-21 F	Distribution of Realized Depreciation: Covered by Old Reserve Prior to 9-21-21 G	Not Covered by Reserves H
9-21 to 12-31-21	1.05%	1.05%	454,052	235,599	218,453	4,768	213,685	.....
Year 1922	5.68%	6.73%	2,650,786	868,414	1,782,372	178,398	1,603,974	.....
Year 1923	5.75%	12.48%	6,171,608	2,928,472	3,243,136	770,217	2,472,919	.....
Year 1924	5.77%	18.25%	4,714,949	1,479,182	3,235,767	860,478	1,929,251	446,038
Total 3¼ Years			13,991,395	5,511,667	8,479,728	1,813,861	6,219,829	446,038
Year 1925	5.76%	24.01%	5,140,470	1,294,740	3,845,730	1,168,627	.....	2,677,103
Year 1926	5.80%	29.81%	7,547,432	1,514,589	6,032,843	2,249,889	.....	3,782,954
Year 1927	5.60%	35.41%	8,910,112	3,623,582	5,286,530	3,155,071	.....	2,131,459
Year 1928	5.58%	40.99%	8,597,660	2,862,790	5,734,870	3,524,181	.....	2,210,689
Year 1929	5.92%	46.91%	8,231,350	3,011,078	5,220,272	3,861,326	.....	1,358,946
Year 1930	5.91%	52.82%	10,342,918	3,419,613	6,923,305	5,463,129	.....	1,460,176
Year 1931	5.78%	58.60%	11,377,070	3,928,465	7,448,605	6,666,963	.....	781,642
Year 1932	4.50%	63.10%	8,540,442	3,807,372	4,733,070	4,733,070*	.....	*
Year 1933	4.18%	67.28%	8,144,396	2,510,261	5,634,135	5,634,135*	.....	*
Total 9 Years			76,831,850	25,972,490	50,859,360	36,456,391	.....	14,402,969
Total 12¼ Years			90,823,245	31,484,157	59,339,088	38,270,252	6,219,829	14,849,007

The above table has been prepared to show in Column H the realized depreciation not covered by reserves as defined by the Interstate Commerce Commission and this commission, and the computations are as prescribed under Account No. 413 in the Uniform System of Accounts for Telephone Companies, first issue, which provides as follows:

"Charge to this account the realized depreciation (i. e. the difference between the original cost and the salvage, if any) on tangible fixed capital retired, if such depreciation has not been provided for through a depreciation reserve. This includes such portion of the realized depreciation on any physical property which was installed prior to the period for which the reserve was established as is due to life in service before that period. This portion may be estimated on the basis of the proportion which the life in service of the property in question prior to the period for which the reserve was established bears to entire life in service."

The figures from 9-21-21 to 12-31-31 were secured from the following sources:

Column A is a composite of the depreciation expense percentages shown in the next to the last column of Wood Exhibits 12, 13-1, 13-2 and 13-3—R. 8182-B and 8183.

Column B shows the cumulative total of the percentages in Column A.

Columns C and D are taken from Wood Exhibit 11, lines 21, 22 and 29—R. 8182-A.

Column E equals Column C less Column D.

Column F equals the Column B percentage of Column C.

The total of Column F, G and H equals Column E.

The figures for 1932 and 1933 in Column A, C and D were taken from annual reports filed by the company with the commission

* As the Column B percent of Column C exceeds the amount of Column E in 1932 by $655,949, there was no realized depreciation not covered by reserves in that year and, therefore, only the amount of Column E is shown in Column F. While a difference of $154,585 would again appear as being not covered by reserves in 1933, it is not shown above for the reason that a sufficient period of time has elapsed to substantially absorb such realized depreciation as has not been covered either by the old reserve prior to 9-21-21 or the new reserve since 9-21-21.

The composite depreciation rate for the year 1921 was 4.14% or approximately 1.05% for the period under review. There was, therefore, credited to the reserve for depreciation on the assets retired during the period from September 21, 1921, to December 31, 1921, 1.05% on $454,052 which would amount to $4,768. The difference between the net realized depreciation, $218,453, and the amount credited to the reserve, $4,768 was $213,685 which, obviously, had to be charged against the reserve for depreciation which the company set up at the time the Ohio State Telephone Company and the original Bell company were consolidated. It will be recalled at this point that the total reserve for depreciation at the time of organization amounted to $6,219,829.

Going to the year 1922 we find that the plant costing originally $2,650,786 was retired (Column C) on which the company recovered as salvage $868,414 (Column D) leaving a net realized depreciation of $1,782,372. Again using the company's composite rate of 5.68% to which should be added the 1.05% which was applied on these assets during the previous year, we find that the cumulative composite rate was 6.73%. Applying this rate on the original cost of plant retired (Column C) it is obvious that depreciation amounting to $178,398 had been credited to the reserve on the assets retired since the date of the company's formation, leaving $1,603,974 which had to be charged against the reserve of $6,219,829 with which the company began business in 1921.

Going next to the year 1924 we find that the original reserve of the company became entirely exhausted and

during this year it was necessary to charge against the reserve for depreciation $446,038 in excess of the credits that had been previously made to the reserve on the assets retired. Carrying these calculations through the years we find that the total charges against the reserve for depreciation were $59,339,088, of which $38,270,252 were covered by the additions to the reserve since September 21, 1921, $6,219,829 were covered by the reserve in existence at September 21, 1921, and $14,849,007 represents the amount of realized depreciation in excess of the credits which had been made to the depreciation reserve on the assets retired. In other words, either the reserve for depreciation at September 21, 1921 should have been $14,849,007 greater or the company should have charged $14,849,007 of these replacements to "surplus" instead of "depreciation reserve", in accordance with the Interstate Commerce Commission regulations.

COMMISSION DETERMINED PERCENT CONDITION AT SEPTEMBER 21, 1921, TO BE 82.78% SHOWING A RESERVE FOR DEPRECIATION OF $14,638,870 INSTEAD OF $6,219,829.

One of the findings of the commission in this case, sustained by the Supreme Court of Ohio, which the company is not appealing to this court, was that the "per cent condition" of the fixed capital at June 30, 1925, the date certain, was 86.46%. It must be regarded, therefore, that this question in the original case has been completely and finally adjudicated. With a per cent condition of

86.46% at June 30, 1925 as fixed by the commission, it can be determined that the per cent condition at September 21, 1921 was 82.78% as shown by the following analysis: (Wood Exhibit 2, R., 8172.)

	Reproduction Value A	Present Value B	Percent Condition C
Fixed Capital found by Commission 6-30-25	108,112,644	93,473,774	86.46%
Less, Net Additions 7-1-21 to 12-31-25	3,171,454	3,171,454	
Computed Fixed Capital as of 12-31-24	104,941,190	90,302,320	86.05%
Less, Net Additions year 1924	6,671,423	6,671,423	
Computed Fixed Capital as of 12-31-23	98,269,767	83,630,897	85.10%
Less, Net Additions year 1923	2,805,318	2,805,318	
Computed Fixed Capital as of 12-31-22	95,464,449	80,825,579	84.67%
Less, Net Additions year 1922	4,701,154	4,701,154	
Computed Fixed Capital as of 12-31-21	90,763,295	76,124,425	83.87%
Less, Net Additions 9-21-21 to 12-31-21	5,754,503	5,754,503	
Computed Fixed Capital as of 9-21-21	85,008,792	70,369,922	82.78%

The per cent condition as at September 21, 1921 of 82.78% thus found is substantially supported by testimony of company witness Stephens (R., 1290) which was to the effect that property of similar character is normally in 83% condition.

By working backward from its final valuation at the date certain we can arrive at the reproduction value and the present value as at the date of the organization of the company. Thus we find the difference between the reproduction value and the present value at that date to be $14,638,870 which represents the amount which should have been carried in its "reserve for depreciation" instead of $6,219,829 as shown by its accounts.

To summarize, the depreciation rates used by the company were high enough during the ten year period from 1921 to 1931 to create an abnormally large depreciation reserve against which could be charged $14,849,007 of replacements, extraordinary repairs and removal costs pertaining to previous years but for which on the assets removed no such depreciation had been provided during the previous years. Stated in another way, excessive depreciation on assets still in service was charged and the excessive reserve so created was used to absorb the loss in scrapping old assets which the company should either have charged against surplus or should have anticipated at the time of consolidation by increasing its initial reserve for depreciation.

REPLACEMENT PROGRAM ABNORMAL AS SHOWN BY TESTIMONY OF COMPANY WITNESSES.

That the replacement program of the company following the consolidation was abnormal is admitted by the company through its chief witnesses, Mr. Williams, its valuation engineer, and Mr. Stephens, its vice president. Mr. Williams testifies (R., 1327) in part as follows:

> "I have also had consideration for the fact that during about the last four or five years there has been placed in the Ohio Bell Telephone Company's property, new property to the extent of almost fifty per cent of the now existing property."

Mr. Stephens testifies (R., 1274) as follows:

"Q. How does the general per cent condition of the total property of your company in Ohio today compare with its per cent condition at any time during 1923-1924 and 1925, if you know? A. It has been greatly improved during that period. In fact, it is getting better every day—every month.

Q. Why is that? A. Due to the fact that we are constructing new property at a considerably greater rate than, in my judgment, the deterioration takes place in the existing property.

Q. How do you know that, or on what do you base your judgment in that respect? A. Well, as testified to this morning, the gross additions to the property from 1923 to 1925 inclusive, not including purchases of going property, amounted to approximately $37,700,000.00 which is at the rate of approximately 12% per year, and I am positive that the deterioration is not growing at that rapid percentage. Furthermore, during the course of my inspection it was very easy to determine as I went along that the condition of the property was getting better.

Q. Have you any further reason for believing that the per cent condition today is higher than in any of the previous years? A. Yes, sir, as testified before, we took out of the plant, including the sales of property, approximately $19,000,000.00 and as a general thing that represented the older parts and portions of the property.

Q. Approximately how much of the present property of the company had been installed within the last four and a half years, if you know? A. I have that for four and a quarter years, that is since the formation of the existing company.

Q. That will do. A. About 45 per cent of the total property."

Mr. Stephens' testimony on pages 1255-1257 is also pertinent on this point:

> "• • • previous to the latter part of 1921 there had been two companies in the field. At that time, I understand—or at least I did understand at the time I came here, and now I know, that those properties were taken together and formed into a new company and the dual service existed at the time I came here and it was going to be necessary to give a unified service. I believe that was the purpose of the consolidation.
>
> • • • Now in connection with this unification and consolidation work and with this construction work to provide telephone service for new subscribers, I would estimate that we have covered at least 75 per cent and possibly 80 per cent of the entire property in this state.
>
> Q. Do you mean by that that 75 to 80 per cent of the property of the company has been reconstructed in this state under your supervision? A. That is it exactly, that is, it has been considered for reconstruction. We did not build 75 per cent of the property new, but in consideration with what we did and the particular areas where we placed this property, we had to rearrange and work over at least 75 per cent of the property in the state".

Appellant in its brief (p. 44) states that the retirement losses during the period under investigation were not abnormal. On page 45, however, is a statement that between 1925 and 1930 an additional investment of $65,000,000.00 in plant was required and "To meet this unprecedented growth, large quantities of all classes of plant had to be retired because of inadequacy". This last statement can only be interpreted to mean that the volume of retirements was certainly abnormal.

Admitting that the program of unification was in the public interest and with the commission's knowledge and approval, it must also be stated, at this point, that the company did not represent to the commission that higher depreciation rates would be necessary to effectuate it. The company fixed its depreciation rates with full knowledge that their reasonableness would be determined in the state wide rate study. The commission has now found that a 4% rate would have been entirely adequate.

COMPANY VOLUNTARILY REDUCED RATE TO 4.18% IN 1933.

It is a singular fact that as shown by Table I the deficiency in the depreciation reserve having been absorbed by the year 1931, the company in 1932 voluntarily reduced its composite depreciation rate from 5.78% in 1931 to 4.50% in 1932, followed by 4.18% in 1933. Certainly this voluntary act on the part of the company can only be construed as indicating that the company had completed its program of replacing the obsolete and duplicating equipment acquired in 1921 and the need for the large depreciation reserves with which to finance this program no longer existed. The contention of the company that the depreciation rates in effect since 1925 were fair and reasonable and should be continued should have no weight in this court even if all of the data contained in the above discussion are disregarded. The depreciation rates used by the company during these years were as follows:

1925, 5.76%; 1926, 5.80%; 1927, 5.60%; 1928, 5.58%;

1929, 5.92%; 1930, 5.91%; 1931, 5.78%; 1932, 4.50%; 1933, 4.18%. Thus it will be seen that the average depreciation rate used by the company between 1925 and 1931 inclusive was 5.76%. The company in 1933 in adopting voluntarily a composite rate of 4.18% gave recognition to the fact that its depreciation needs will be 27.43% less beginning with 1933 than they were between 1925 and 1931. The statement in appellant's brief (p. 48), in so far as inadequacy is concerned, is partial admission of this fact. Can the company, in view of its own act, deny that their replacement experiences between 1925 and 1931 were abnormal? Could the company, in good faith, expect the commission to accept these high rates as normal and as being necessary in order to maintain its physical plant?

Appellant in its brief (p. 37) attempts to convince the court that the commission studied only the retirement experiences of the company between 1921 and 1925 and neglected to examine the experiences between 1925 and 1933.

The inaccuracy of the above statement is apparent. The commission had all of the preceding data before it dealing with replacements and retirements from 1921 to 1933, and arrived at its judgments after a careful inquiry concerning the amount and nature of these retirements.

PROPERTIES ACQUIRED SINCE 1921 WITH INADEQUATE DEPRECIATION RESERVES.

With respect to the inadequacy or entire lack of depreciation reserves in connection with purchased properties, the commission found exactly the same circumstances applicable to a lesser degree and considered that the depreciation which had taken place in such properties up to the time of their acquisition should have been provided for out of the earnings of those properties previous to the date of acquisition. Whatever the circumstances may have been which resulted either in the failure of the selling companies to provide for or record adequate depreciation or the failure of purchasing company to recognize and record the amount thereof on its books, these circumstances should not be permitted to shift the burden of making good such neglected depreciation out of current earnings of the purchasing company. It is apparent that such a shifting of burden has taken place in this case and that due to these unwarranted demands on the earnings of The Ohio Bell Telephone Company, its charges for depreciation expense requirements have been unduly excessive. The measure of this excess is obtained from an analysis of the properties and reserves acquired by purchase as shown on Wood Exhibit 18 (R., p. 8190-D) which has been summarized and interpreted as follows. This summary shows that the company acquired depreciation reserves of $7,539,736 which the commission interprets should have amounted to $17,459,656, leaving a deficiency in reserves acquired of $9,919,920.

Wood Exhibit 18	As Recorded on Books			As Interpreted by Commission		
	Book Cost	Depreciation Reserve	% Cond.	Book Cost	Depreciation Reserve	% Cond.
Old Ohio Bell & Ohio State Tel. Cos. (line 3)....	69,070,160	6,219,829	90.99	85,008,792	14,638,870	82.78
Properties purchased with Reserves (lines 4, 5, 8, 10, 20, 21, 26, 27, 34 & 39).	6,514,206	1,319,907	79.74	6,514,206	1,319,907	79.74
Properties purchased without Reserves—A. T. & T. Co. (line 22)	1,579,593	—	—	1,928,549	943,729	51.07
Other properties prior to 1-1-25 (lines 6, 7, 9, 11, 14)	1,481,987	—	—	1,481,987	300,251	79.74
Other properties since 1-1-25 (lines 15, 17-19, 23-25, 28-33 and 35-38)	1,268,010	—	—	1,268,010	256,899	79.74
	79,913,956	7,539,736	90.57	96,201,544	17,459,656	81.85

The deficiency in the reserves acquired from The Ohio Bell and Ohio State Telephone Companies amounts to $8,419,041, and was computed in connection with checking the "per cent condition" of the property, as has been heretofore discussed.

The deficiency in the reserves acquired from the American Company amounting to $943,729, pertains to the telephone instruments purchased from that company as of December 31,1927. The total instruments disposed of by the American Company were sold to various Bell operating companies for a consideration of $38,183,727 (Exhibit X121, R., p. 9061), and of this amount The Ohio Bell Telephone Company purchased $1,579,593 or 4.14%. (Wood Exhibit 18, line 22, R., p. 8190-D.) This total amount of instruments stood on the books of the American Company at a cost of $46,583,314, less a depreciation reserve of $22,795,386, or at a net book value of $23,787,928. (Exhibit X121.) Applying the 4.14% to these figures produces the proportion thereof applicable to The Ohio Bell Telephone Company in the amounts of $1,928,549, gross book cost, $943,729 depreciation reserves and $984,820 net book cost. When the close inter-company relationship between the seller and purchaser in this case is considered and the fact that the American Company realized a profit on the transaction of $14,395,799 (Exhibit X121), of which 4.14% or $595,986 was allocable to sales to The Ohio Bell Telephone Company, there appears to be no justification whatever of recording the transaction on the books of the latter company in such a way as to deprive it of the accrued depreciation reserve

of $943,729, as of the date of purchase. This procedure places an undue burden upon the operations of The Ohio Bell Telephone Company and its subscribers, to again build up a reserve on a large amount of telephone instruments which were about to become obsolete due to change in public demand for a more modern type, especially when the portion of such reserve which had already been created was withheld and retained by the parent company in its surplus account for the benefit of its stockholders.

The deficiency in the reserves acquired from other companies on properties purchased prior to January 1, 1925, $300,251, and properties purchased since January 1, 1925, $256,899 has been estimated by the commission on the basis of applying to such properties the same "per cent condition", 79.74% as the record shows applied to the properties acquired from companies where depreciation reserves were recorded. It is understood that in recording the purchase of these properties without reserves the company entered only the net or depreciated value of the property on its books, and while this net value is not questioned, this method of recording resulted in showing these properties as being in 100% condition. It was, therefore, necessary for the commission to determine the approximate amounts that should have been taken into the depreciation reserve account, in order to give proper consideration to the depreciation requirements. This has been the purpose of estimating these unrecorded reserves and due weight thereto has been given in the determination of the allowance for depreciation expense.

With respect to the amount of depreciation expense required to maintain a proper depreciation reserve, the commission has not disturbed the amount set aside by the company prior to 1925 as it antedates the period covered by this inquiry. However, in considering the period covered by this inquiry the commission has made a reduction of $17,267,353 in the amount of depreciation on telephone plant and equipment, but as to the depreciation expense on general equipment amounting to $2,096,017, it has made no change in the amount shown by the company's books. The reduction above referred to is occasioned by the use of a 4% annual rate, instead of the annual rates used by the company, applied to the value of the depreciable fixed assets affected thereby in the manner shown in Appendix K of the commission's opinion. (R., 242.) The commission was satisfied that this was a fair and equitable rate, fully adequate to meet the normal depreciation requirements of the company. It appears significant that, having passed through the period during which the book reserve was adversely affected by the erroneous treatment of reserves on purchased properties and realized depreciation not covered by reserves, above commented upon, the company voluntarily reduced its annual depreciation rate to the more normal figure of 4.18% in 1933 and still carries forward an excessive depreciation reserve balance of $21,999,901, which causes its books to show the relatively low "per cent condition" of 86.81% at December 31, 1933.

FOUR PERCENT RATE, DUE TO HIGH SALVAGE RECOVERY, MEANS COMPOSITE LIFE OF 18.24 YEARS.

It might at first be assumed that the 4% depreciation rate which the commission prescribed contemplates a composite life for the entire plant of twenty-five years. This assumption would be erroneous. In the first place, the rates of depreciation in use by the company on special classes of equipment, namely, general stable and garage equipment, general store equipment, general tools and implements were not disturbed. The 4% rate applies to all other classes of depreciable telephone plant and equipment accounts. Again, as testified by company witness Stephens (R., p. 1290), the salvage recovery in the telephone industry is unusually heavy, being about 23%, thereby reducing the amount which must be charged against the reserve when replacements are made. Referring to Wood Exhibit No. 11 (R., p. 8182-A), it is found that for the period from September 21, 1921, to December 31, 1931, the cost of plant removed or abandoned was $71,584,815 and the cost of plant sold was $2,553,592. In scrapping these assets, a total of $25,166,524 was recovered as salvage which is partially offset by the cost of removal and extraordinary repairs aggregating $5,121,578. The net recovery from assets costing $74,138,407 was, therefore, $20,044,946. The net depreciation to provide for at a 4% rate was, therefore, $54,093,461. By the application of a 4% rate to the base

figure ($74,138,407), the net sum ($54,093,461) could be accumulated in 18.24 years. This would mean that the company could replace 5.48% of its physical plant each year with the depreciation reserve that would be accumulated under the 4% rate prescribed by the commission.

FOUR PERCENT RATE GIVES PERCENT CONDITION AT DECEMBER 31, 1933, OF 91.21%.

The net result of the commission's findings is clearly shown in the following summary:

Depreciation Reserve:*	Shown by Books of Co. A	Reconstructed from Record B	Increase of Decrease (*) C
1. Balance Depreciation Reserve 9-21-21	6,219,829	14,638,670	8,419,041
Credits 9-21-21 to 12-31-24:			
2. Depreciation Expense—Plant and Equipment	14,214,948	14,214,948	.....
3. Depreciation Expense—General Equipment	499,750	499,750	.....
4. Transfers and Adjustments	9,915	9,915	.....
5. Recorded Reserves on Purchased Properties	610,231	610,231	.....
6. Unrecorded Reserves on Purchased Properties	.....	300,251	300,251
7. Total 9-21-21 Balance Plus Credits	21,554,673	30,273,965	8,719,292
8. Less, Net Charges 9-21-21 to 12-31-24	9,728,614	9,728,614	.....
9. Balance Depreciation Reserve 12-31-24	11,826,059	20,545,351	8,719,292
10. Depreciation Expense—Plant and Equipment	62,533,967	45,266,614	*17,267,353

Depreciation Reserve:*	Shown by Books of Co. A	Reconstructed from Record B	Increase of Decrease (*) C
11. Depreciation Expense—General Equipment	2,096,017	2,096,017	.....
12. Transfers and Adjustments.	81,094	81,094	.....
13. Reclassifications	272,424	272,424	.....
14. Recorded Reserves on Purchased Properties	708,582	708,582	.....
15. Unrecorded Reserves on Purchased Properties	.....	1,200,628	1,200,628
16. Total 12-31-24 Balance Plus Credits	77,518,143	70,170,710	*7,347,433
17. Less, Net Charges 1-1-25 to 12-31-33	55,518,242	55,518,242	.....
18. Balance Depreciation Reserve 12-31-33	21,999,901	14,652,468	*7,347,433

From this statement the court will note that if the company had started business in 1921 with a depreciation reserve of $14,638,870 instead of $6,219,829 and if properties purchased subsequent to that date had been recorded on the books of the company with reasonable reserves for depreciation, the balance in the reserve for depreciation account would have been increased $9,919,920 (Lines 1, 6, and 15 of above statement).

In company brief (page 47 supported by table on page 15) criticism of the 4% rate prescribed by the commission is made to the effect that if the rate had been applied from 1925 to 1933 the balance in the reserve would have been only $3,908,911. In making this calculation, the above deficiency of $9,919,920 in the reserves on purchased properties has been completely ignored. If this amount is added to the $3,908,911 computed by the company, a corrected balance of $13,828,831 would be obtained. This would show a percent of the reserve to the

average cost of depreciable property for 1933 (Column 6 to Column 3) of 9.32% instead of 2.64% as shown in Column 7. In terms of percent condition, this would amount to 90.68% which appears to be entirely reasonable.

As a result of using the 4% annual depreciation rate on all classes of depreciable telephone plant and equipment except such general equipment items for which the book depreciation rates were approved, and of considering only the inadequacy of reserves acquired by purchase, but not the item of realized depreciation not covered by reserves, a corrected depreciation reserve balance of $14,652,468, at December 31, 1933, is arrived at. A further proof of the adequacy of this reserve in comparison with the value and percent condition of the property can be made as follows:

	Gross Fixed Capital	Depreciation Reserve	Per Cent Condition
Comparisons as of 12-31-33			
1. Compared with books:			
Book Value and Book Reserve	166,757,394	21,999,901	86.81%
Book Value and Corrected Reserve	166,757,394	14,652,468	91.21%

It has been previously pointed out that the 86.81% condition shown by the books is unreasonably low considering the extent to which additions of new plant replacing old plant have been made. Substitution of the corrected reserve results in showing the much more logical 91.21% condition at 12-31-33.

CRITICISM OF INCONSISTENCY MADE BY COMPANY ENTIRELY WITHOUT FOUNDATION.

On page 38 of the company's brief criticism is made to the effect that the commission was inconsistent to the extent that it determined the ratio of actual retirement losses to undepreciated costs for the period from September 21, 1921, to June 30, 1925, and having found this ratio to be 3.74%, fixed a rate of 4% to be applied on the present value as at that date (Reproduction New Less Depreciation) and also to be applied in each of the succeeding years to the present value at the date certain plus net additions at actual cost. The facts which apparently the company had in mind are the following:

	Commission's Valuation		*Company's Books*	
	Reproduction	*Present*	*Undepreciated*	*Depreciated*
Total Fixed Capital...	108,112,644	93,473,774	98,712,030	86,151,527
Less, Non-depreciable Property*	10,378,814	9,142,880	8,882,771	unknown
Depreciable Property	97,733,830	84,330,894	89,829,259	unknown
4% depreciation allowed		3,373,236		
% of other values of Depreciable Property	3.43%	4.00%	3.78%	3.915%

* While some of this property is depreciable, the rate of depreciation and the amounts allowed by the Commission are not disputed. It is termed "Non-depreciable Property" only to differentiate from "Depreciable Property" subject to dispute.

The company complains that the commission's allowance of 4% on present value at June 30, 1925, amounts to

only 3.45% on reproduction cost new value at that time. It does not advance any arguments in support of the principle that it should recover through subsequent depreciation allowances any amount in excess of the value found by the commission as being used and useful for service of the public as of June 30, 1925. This amount shows the present value of $84,330,874.

This charge of inconsistency is entirely without foundation. Throughout this case it was certainly understood by both the company and the commission that due to the impossibility of obtaining the original costs of the properties acquired by The Ohio Bell Telephone Company in 1921 with any reasonable degree of accuracy (Hagenah Exhibit, R., 6549-6550) appraisal of the property as at June 30, 1925, was to be used as a base figure for the purpose of fixing the rate of return and the depreciation rate throughout subsequent years. Due to the practice of the company heretofore referred to in this brief (page 96) of taking over properties from the predecessor companies without depreciation reserve and merely recording them on the new books at net present value figures, no alternative was present. In the final analysis, the depreciation rate should provide for the recovery of capital funds invested during the expected life of such property. It is apparent, as shown by the commission's analyses, that a 4% rate applied on the present value at June 30, 1925, and continued during the subsequent years on this value and also upon the actual costs of net additions will enable the company to fully recover these values in accordance with the accounting regulations pre-

scribed by the Interstate Commerce Commission and by The Public Utilities Commission of Ohio (see page 83).

What the commission attempted to do was to determine a rate which, when applied to present value as at June 30, 1925, would be equivalent to the 3.74% rate applied to original cost which was determined by an examination of the replacement experiences to be adequate. The court will observe in the above table that the company's books showed the original cost of the property to be $89,829,259 and the present value assigned to such property by the commission was $84,330,894. In other words, the company's original cost *undepreciated* was 106.5% of the commission's present value (cost of reproduction less depreciation). 106.5% of 3.74% gave the commission 3.98% to be applied on present value. This percentage was rounded out to 4%. The company's contention falls completely for the reason that a 4% rate applied on present value will actually premit the company to charge slightly more than its retirement experiences between 1921 and 1925 had required. The 4% rate on present value was intended to be the 3.74% rate on actual cost and their criticism of inconsistency is without merit.

All of the preceding tests and analyses establish the reasonableness of the 4% depreciation rate prescribed by the commission in making provision for the retirement and abandonment of units of property when they, through physical wear and tear, obsolescence and inadequacy must be replaced by new and modern units.

NET EFFECT OF APPLICATION OF COMMISSION'S 4% DEPRECIATION RATE.

The commission followed the principle that the depreciation charge for rate making purposes should be high enough to maintain the telephone plant in a state of high efficiency but that improvement in the form of substitution of one hundred per cent new property for old and obsolete property should not be made at the expense of the patrons of the company. It ascertained that $14,849,007 of such improvements had been so charged and it was liberal in permitting $6,429,966 of these charges against the depreciation reserve to stand.

The commission permitted all excessive depreciation from September 21, 1921, to June 30, 1925, to remain.

The commission limited the depreciation charges since June 30, 1925, to the amount which would be normally required to maintain the property. It took the position that the present patrons should not be assessed for depreciation which took place years ago for which the company did not make adequate provision. On this point the position of the commission is unassailable. Any suggestion to this court that such costs of improvements in physical property are to be recognized as operating expenses is absurd.

The fact is that the rates of depreciation prescribed by the commission were entirely adequate to produce a sum sufficient to replace appellant's property on the ex-

piration of its life and the finding of the commission to that effect is fully supported by the record.

In a recent decision of the court *(Clark's Ferry Bridge Company v. Public Service Commission of Pennsylvania,* 291 U. S., 225, 240; 78 L. Ed., 767, 774) it was held that:

> "The question of the amount which should be allowed annually for depreciation is a question of fact. • • • In reviewing the findings of the state court we are not required to enter a debatable field of fact and to choose and prescribe an invariable method of computation. To justify the overruling of the determination of the state court we must be able to see that what has been done will produce the result which the Constitution forbids. • • •"

Cf. *Michigan Public Utilities Commission v. Michigan State Telephone Co.*, 228 Mich., 658, 200 N. W., 749;

Lindheimer v. Illinois Bell Telephone Co., 292 U. S., 151, 78 L. Ed., 1182;

St. Joseph Stock Yards Co. v. United States, 298 U. S., 38, 78 L. Ed., 1033.

The Supreme Court of Ohio concluded an extended discussion of this subject with the following statement (R., 581-2):

> "We have made a conscientious examination of the voluminous evidence relating to 'depreciation' and have analyzed it to the best of our ability with regard to the conflicting contentions of the adverse parties. There being substantial support for the findings and order of the commission on this feature of the case, they wil be permitted to stand."

LICENSE CONTRACT PAYMENTS.

An administrative body such as The Public Utilities Commission of Ohio, in passing upon the reasonableness of the operating expenses of a public utility operating under its jurisdiction, is not bound to accept as conclusive the amounts allegedly paid by such public utility to its parent company for services presumably rendered by the parent company to the operating company under a license contract made between these affiliated concerns but such an administrative body may inquire into the value and the propriety of such services, and upon the basis of the evidence introduced and in the exercise of its administrative discretion, it may determine the fair and reasonable value of the services and the propriety thereof, and this determination made upon proper evidence should not be disturbed by any reviewing court.

As a part of its annual operating expenses the company claimed substantial amounts to cover what is known as license contract payments made by it to its parent corporation, American Telephone and Telegraph Company, for services allegedly furnished by the American Telephone and Telegraph Company to The Ohio Bell Telephone Company. The commission, after careful consideration, was of the opinion that a portion of the payments claimed was for the purpose of defraying costs incurred by the parent company with no resultant benefit to the operating company. These payments were therefore disallowed and they represent substantially all of the reductions made by the commission in the license contract payments claimed by the company. These re-

ductions as made by the commission are reflected in the following table:

Year	License Contract Payments Claimed By Company	Amount Allowed by Commission
1925	$1,237,644	$505,215
1926	1,239,094	557,090
1927	1,356,855	615,849
1928	727,157	406,709
1929	602,828	427,055
1930	615,775	514,869
1931	595,581	501,231
1932	529,796	506,494
1933	453,849	453,849

(Commission Finding, Appendices F, G, H, I and J, R., 236-41.)

For a complete discussion of this topic see commission's opinion (R., 206-19).

In studying the foregoing table, it is interesting to observe that the heaviest reductions made by the commission in the license contract payments occurred in the years 1925 to 1928 inclusive, and that the differences between the amounts claimed by the company and the amounts allowed by the commission for the years 1929 to 1933 grew progressively less until in the year 1933 the amount allowed by the commission equaled the amount claimed by the company.

When it is recognized that prior to 1926 the payment under the license contract was 4½% of the gross revenues, and that beginning January 1, 1926, it was 4% of the gross revenues, and beginning January 1, 1928, it was 2% of gross revenues, and beginning January 1,

1929, it was 1½% of gross revenues (R. 6804A; 6815-17), the court will understand the basis for the greater reductions made by the commission in the earlier years, for if the parent company could, beginning January 1, 1929, perform services for the benefit of its subsidiaries at a cost of 1½% of its gross revenues where it formerly performed these services at a cost of 4½% of its gross revenues, there must have been some period where the services were rendered at excessive costs.

The position of the company apparently is that since evidence was introduced to the effect that certain payments had been made by it to its parent company, American Telephone and Telegraph Company, for services rendered by the parent company to it, that the commission was bound to accept these payments in the full amount claimed and allow them as a part of the company's operating expenses for the purpose of determining the fairness of its rates. In other words, that the payments so made by the subsidiary company to the parent company for services allegedly rendered to the subsidiary company by the parent company must be accepted by the commission as conclusive as to the value and propriety of these services. Such a contention is not supported by law.

Western Distributing Company v. Public Service Commission of the State of Kansas, 285 U. S., 119, 75 L. Ed., 655;

Smith v. Illinois Bell Telephone Company, 282 U. S., 133, 75 L. Ed., 255;

Dayton Power and Light Company v. Public Utilities Commission of Ohio, 292 U. S., 290, 78 L. Ed., 1267;

Columbus Gas & Fuel Company v. Public Utilities Commission of Ohio, 292 U. S., 398, 78 L. Ed., 1327.

The question here presented therefore is not whether or not the amounts paid by The Ohio Bell Telephone Company to American Telephone and Telegraph Company were actually paid, but rather whether or not the amounts paid represent the true value of the services rendered and is concerned with the propriety of the charges assessed by the parent corporation against its subsidiary *(Smith v. Illinois Bell Telephone Company,* supra). Certainly The Public Utilities Commission of Ohio is not bound to accept the amount which the company contends that it has paid to its parent corporation under a license contract made between affiliated companies as conclusive evidence of the propriety and value of the charges covered by the contract.

On the contrary, under the decisions of this court, The Public Utilities Commission of Ohio may determine the reasonableness and the propriety of the amounts to be included in operating expenses of an operating company in such a case and its findings in that connection should not be disturbed by a reviewing court unless its decision is manifestly against the weight of the evidence and constitutes an abuse of the administrative discretion vested in the commission.

In the case of *Smith v. Illinois Bell Telephone Company,* 282 U. S., 133, this court said:

> "In view of the findings, both of the state commissions and of the court, we see no reason to doubt that valuable services were rendered by the American company, but there should be specific findings by the statutory court with regard to the cost of these services to the American company and the reasonable amount which should be allocated in this respect to

> the operating expenses of the intrastate business of the Illinois Company in the years covered by the decree."

And that is precisely what the commission did. It did not challenge the fact that some services had been rendered by the American Company to The Ohio Bell Telephone Company, but it was unwilling to accept these charges in the face amount contended for by the company and accordingly made certain reductions therein, and, as we have heretofore indicated, the commission's findings in this connection should not be disturbed by this court unless the commission acted arbitrarily and unreasonably and contrary to law.

The company in its brief (Appellant's Brief p. 51 and 52) contends that it proved the cost to the American Company of furnishing the license contract services by first showing that the license contract services were needed and used by appellant and valuable to it in the operation of its telephone plant; secondly, by showing that the appellant's payments therefor during the period did not exceed the actual cost to the American Company of furnishing the services; by showing thirdly, that the allocation to appellant's intrastate business of its proportion of such cost was proper and finally, by showing that the services were worth more than appellant's payments therefor. The company will admit, however, that the "proof" to which they refer is predicated upon allocations made by various employees of the company and at the best is based upon estimate and opinion judgment, and that no records have been kept by the American

Company showing separately the cost of rendering license contract service (R., 3336; 3338; 3392; 3529; 3534). In the face of such "proof" largely conjectural in its nature, the commission certainly was left free to exercise its judgment as to what would be a proper allowance to the American Company under the license contract.

Field Occupied by the American Telephone and Telegraph Company.

The commission in its opinion (R., 207-10) points out that it is difficult, if not impossible, to determine with any degree of correctness the value and the cost of the services rendered by the American company to its Bell subsidiaries without a thorough comprehension of the wide field occupied by the American company.

Without repeating the entire discussion contained in the commission's opinion on this subject, we should like to recite briefly certain portions of the opinion in order that the court may understand the many ramifications of the American Telephone and Telegraph Company.

The American company owns directly or indirectly more than 90% of the combined voting stock of the twenty-four companies associated with it as the Bell system, together with the long distance lines which connect the wires of the different companies. The Bell system forms an inter-communicating system of nearly fourteen million telephones with which are connected the lines of nearly seven thousand other companies and more than twenty-six thousand rural lines covering the entire United States. Service is provided to Canada, Cuba and

Mexico by wires and by radio telephone to most of the countries of Europe, South America, South Africa and the islands of the sea, so that 92% of the entire telephones of the world can be reached by the Bell system.

In 1931 the telephone company introduced the use of the teletype writer, a valuable adjunct to the newspaper service.

The company owns 98% of the stock of the Western Electric Company, 50% of the Bell Telephone Laboratories by direct ownership and practically the remaining 50% through its ownership of the Western Electric; all of the stock of the Bell Telephone Securities Company, the Eastern Telephone and Telegraph Company of Canada and 50% of the stock of the Cuban company.

The Bell Telephone Company of Canada, of which stock the American company owns 24%, owns and operates toll lines and telephone exchanges in Quebec and Ontario. Through the Cuban company it owns certain valuable concessions and rights in Cuba and has submarine cables to that island.

The Western Electric Company manufactures and distributes telephones and other electrical apparatus mostly to the Bell system. It is also purchasing agent for that system. Its largest manufacturing plant is at Hawthorne, Illinois, with at least two other important plants. The company formerly conducted a foreign business which in 1925 it sold at a large profit. Its present territory now corresponds to that of the Bell system. Upon the sale in 1927 by the Western Electric of its foreign business a cash dividend of $48,000,000 was received by

the American company, which was added to the surplus of the company.

The American company and the Western Electric Company own jointly the Bell Telephone Laboratories, it being nearly all owned by the American company through its ownership of the stock of the Western Electric. This company took over all the research and development functions formerly performed by the Western Electric.

The inventions of the telephone laboratories have contributed to the progress of electrical science outside the strictly telephone field. To make these developments available in such other fields the Electrical Research Products, Inc., was organized in 1926, wholly owned by the Western Electric and through it by the American company. Non-telephone activities were thus given special attention without conflict with the telephone work. Such activities relate to submarine cables, phonographs, talking motion pictures and many other activities.

In 1930 the American company acquired the Teletype Corporation now operating as a subsidiary of Western Electric. The American company also owns the Bell Securities Company to facilitate transactions in Bell Telephone securities.

The American company has other contracts with telephone companies and is engaged in the development of the use of telephone wires for broadcasting and has developed short wave transmitting telephone stations for foreign service and for communication with airplanes and with ships at sea. The company through its research

activities has secured patents covering inventions of its research laboratories in the field of radio and has recently turned over to the Radio Corporation of America the right to manufacture and distribute radio equipment utilizing such inventions. It has also been active through its laboratories in the development of the art of television and telephoto and has engaged in many other activities reaching out and developing new sources of profit not connected with telephone business.

Limitations of space and time do not permit of a complete discussion of the varied and numerous activities of the American Telephone and Telegraph Company and in the foregoing statement we have attempted merely to set forth briefly some of the activities of this company in order that the court may understand a little more clearly the problems that are here presented in so far as license contract costs are concerned.

THE COMMISSION'S DISALLOWANCE OF PORTIONS OF LICENSE CONTRACT COSTS.

Before the Supreme Court of Ohio, the appellant attempted to substantiate its claim for additional allowances for payments made under its license contract with the American company, by the submission of ten different classes of costs disallowed by the commission either in whole or in part for services rendered in the following departments: Department of development and research; information department; personnel department; public relations department; treasurer's department; comptroller's department; secretary's department; adminis-

tration department and general service bureau; department of operations; depreciation of telephone instruments; contingent liability for patent infringement assumed by American company under the license contract.

In this court, the appellant has abandoned its contentions with respect to the information department; the public relations department; secretary's department; administration department and general service bureau: department of operations and depreciation of telephone instruments, leaving for this court's consideration only the department of development and research; contingent liability for patent infringement; treasurer's department; personnel department and comptroller's department.

We shall, therefore, consider briefly each of these divisions separately.

Department of Development and Research.

This department was organized in 1919 (R., 3538). The expenses charged under this heading included all of the expenses of the department, together with a portion of the engineering department of Western Electric. In 1925 Bell Telephone Laboratories, Inc., was incorporated by American Telephone and Telegraph Company and Western Electric and American Telephone and Telegraph Company's portion of the costs of Bell Telephone Laboratories is included from that date on (R., 3384-86; 3546). This department unquestionably performs some services of benefit to the associated companies. The difficulty with the company's allocations, however, is that it charges practically all of the expenses to the operating

companies without crediting any of the benefits to those companies.

Since the inception of this department in 1919 the company has not credited against the cost of operating it any of the moneys received by way of royalties nor has it shown any credits for the profits received from non-Bell sales of telephonic appliances made by International Western Electric and its subsidiaries Northern Electric Company, Ltd., International Standard Electric, Automatic Electric or Graybar, where American Telephone and Telegraph inventions were used without any royalties. In the footnote of Heiss Exhibit A-201-B (R., 8843), appear the total amounts which the company claims to have received from royalties and license fees during the period 1923-1931, aggregating $5,229,141 for the period (see also R., 8837). Nowhere is it shown in dollars exactly what the benefit to American Telephone and Telegraph has been by reason of the sale by the above named companies of products manufactured under American Telephone and Telegraph patents. The company by license contracts with General Electric, Radio Corporation of America, Westinghouse Electric, and others, as far back as 1920, was assured of the use of patent rights owned or acquired by these companies so far as their use in the telephonic field was concerned, while they in turn were given the benefit of American Telephone and Telegraph patents in radio. None of these benefits to American Telephone and Telegraph Company as the parent company were estimated or credited by it

against the cost of the development and research department.

The commission in passing upon this particular subject concludes its discussion as follows (commission opinion, January 16, 1934), (R., 211-12):

> "The state admits that this department does much to benefit the associated companies, but we are of the opinion that numerous expenses and costs claimed are not related to Ohio Bell Telephone operations and do not constitute a proper charge under the license contract. This appears self-evident from the nature of the service for which the expenditures are made. We are disposed to and do eliminate and disallow all costs and expenses incident to the following services and items: picture transmission, television, radio and submarine cable telephone connecting equipment and circuits, radio transmission systems, vacuum tubes, photo electric cells and submarine cables. These items and amounts charged for each appear in Exhibit A-118-B. The amounts disallowed for the year 1925 and subsequent years to 1931 inclusive are set forth in Appendix 'I' hereto attached.
>
> "The remainder of the costs claimed by the company in the department of development and research will be allowed as proper license contract expenses."

Contingent Liability for Patent Infringement Assumed by American Company Under the License Contract.

The company claims approximately $1,000,000 as a cost allocable to The Ohio Bell Telephone Company for the period involved in connection with this particular service of the parent company. The commission disallowed the contention of the company in the following

language: (Commission opinion, January 16, 1934, R., 218.)

> "The license agreement also provides that the licensee is entitled to receive from the licensor services in relation to patented and improved devices, and immunity from loss by reason of infringements.
>
> "The possibility of infringement damage is too remote to charge the rate payer for a cost or expense which does not exist and not likely to arise when we consider that during all the years from 1925 to the present time there has been no cost to the American company in the way of loss or damages because of patent infringements of apparatus used by the patrons of the Ohio Bell Company.
>
> "We consider that having allowed all of the legal expenses claimed for by the American company that whatever services may have been rendered in the way of defending infringement cases have been fully compensated in the allowance of legal services already mentioned. For said reasons no amount is allowed as operating expenses under said license contract for alleged patent infringement by way of losses, damages or otherwise, except as already noted in the way of legal expense."

In its brief (Appellants Brief, p. 58), appellant contends that two suits involving patent infringements had been instituted against the American company and licensee companies involving several hundred millions of dollars. That the amounts claimed were extravagant is admitted (R., 4644), and the fact is nothing was paid on such claims. Furthermore, appellant was not involved in such suits. It would seem that when appellant had paid to the American company large sums ranging from 4½% to 1½% of its gross revenues for the use of

patented devices it had paid all it should for the use thereof and should not be required to contribute additional large sums for indemnity against the use of a patent already amply paid for.

In its discussion of this topic the company in its brief (Appellants Brief, p. 58), quotes from the decision of the statutory court in the Illinois Bell case *(Illinois Bell Telephone Company v. Gilbert et al.*, 3 Fed. Supp., 595). Suffice to say that the decision of the statutory court in the above entitled case was reversed by this court in the case of *Lindheimer v. Illinois Bell Telephone Company*, 292 U. S., 151, 78 L. Ed., 1182, and by virtue of that decision the Illinois Bell Telephone Company was directed to repay to its subscribers in the Chicago area approximately $30,000,000 in refunds.

Treasurer's Department.

The functions of the treasurer's department were described by Mr. Heiss (R., 3350-1). The allocations for this department were made by Mr. Heiss (R., 6804-A), although he was not the responsible head, the treasurer of the company being Mr. Hugh Blair-Smith (R., 4227). Mr. Blair-Smith testified by deposition as to the costs of this department dividing them into six groups:

1. Cost of handling new security issues.

2. Cost of servicing outstanding securities of A. T. & T. Co.

3. Cost of handling funds in making advances sought by associated companies.

4. Cost of financing general department of A. T. & T. Co.

5. Cost of handling employee stock plan.

6. Cost of advising associated companies and long lines in their treasury work.

(R., 4227-55; 214).

The definitions of the nature of these various group expenses was also given by Mr. Blair-Smith (R., 44227-55). Groups 1, 2 and 4 are so clearly holding company operations that they should not need further comment. Group 3 is a cost which is directly comparable to the cost of operating a bank and the amounts naturally should be eliminated inasmuch as the associated companies pay interest on all of these loans. To permit these charges as license contract costs would simply amount to allowing additional interest without showing it as such. Group 5 represents the cost of distributing A. T. & T. stock to the employees of the Bell system under the employees' stock plan. Group 6 is obviously the only recognizable expense which should be allocated to the license contract service. In spite of the definitions of these various activities by Mr. Blair-Smith, Mr. Heiss took the totals of all these amounts, allocated approximately 6% to holding company operations and distributed the balance of approximately 94% between long lines and the associated companies. (Heiss Exhibit, A-154-B, R., 8806).

The commission in its discussion of this topic points out that the cost of these various groups within this department, with the possible exception of Group 6, are

entirely for the benefit of the American company and are not proper charges against the operating company and therefore disallowed all items charged for under the headings: direct distribution of securities, servicing securities, handling funds and making advances, financing general department and handling employees' stock plan. The balance of the costs as claimed by the company in this department were allowed by the commission (R., 214).

Personnel Department.

The commission disallowed a portion of the cost of the personnel department as contended for by the company. It expressed the reason for so doing in the following language. (Commission opinion, January 16, 1934, R., 212-3):

> "It appears to us that the scope of the work of this department is rather in the interest of the holding company than that of the licensee and the cost thereof not proper charges against the rate payer of the operating company, but considering that the state has admitted the propriety of some of the items and objected to others, we are disposed to adopt the state's figures and disallow those items set forth by the state in Appendix D of its brief, consisting of the following: Special training A. T. & T. Co., employees, 'other' items shown in Column 4, Exhibit A-150-B, public relations, 'other' items shown in Column 4, Exhibit A-151-B and interest on employees' benefit fund, Exhibit Heiss No. 10 Supl. The items so disallowed for the years 1925 to 1931 inclusive are set forth in Appendix 'I' hereto attached. The remaining items of cost in the personnel department will be allowed as claimed."

In deposition Exhibit 193 (R., 9304), Mr. Edwin F. Carter, head of the department, allocated a proportion of the expenses of this department to "other activities." In other words, Mr. Carter himself did not consider them allocable to the licensee companies. However, in this, as in some other departments, Mr. Heiss, exercising his judgment, picked up all these amounts and reallocated them on the basis of 10% to non-license and 90% to license contract services (Heiss Exhibit A-150-B, R., 8802). Granting these are judgment allocations, it is believed that the head of the department involved is more properly able to determine what should be charged to licensee companies than the comptroller, unless it be for the sole purpose of attempting to justify the license contract charges. And finally, upon the basis of the testimony introduced (R., 3344-5), we submit that the entire scope of its work is in the interests of the holding company and very properly could have been disallowed in its entirety.

Comptroller's Department.

The commission, in discussing this particular department, says (commission opinion, January 16, 1934, R., 214-5):

> "This department deals largely with statistics, general books and records and reports and we are inclined to the view that these activities are rather those pertaining to the holding company than to the operating companies. However, the state concedes the propriety of some of the charges as proper items of expense and we therefore adopt the state's posi-

tion in allowing part and disallowing other items. The figures disallowed are those set forth in Appendix D of the state's brief consisting of the cost pertaining to the following functions of that department: general books and records, chief statistician, Bell system reports, and proportion of subheads 'undistributed' and 'administration' appearing in Exhibit A-155-B. The items so disallowed are shown on Appendix 'I' hereto attached. All other items included in said department costs consisting of Bell system methods, chief traveling auditor, chief accountant and proportion of subheads 'undistributed' and 'administration' are allowed. The items so allowed for the respective years appear in Appendix 'H' hereto attached."

Mr. Heiss' final allocations for this department for the years involved is set forth in Exhibit A-155-B (R., 8808). Mr. Heiss defines the functions of his own department (R., 3348-50). The fact is that Mr. Heiss' allocations would carry greater weight had they been uniform in their application to the various rate cases in which the Bell companies have been involved in the different states, but it is a fact that Mr. Heiss presented different allocations in Ohio, Michigan and Illinois.

III.

THE CONTENTION OF THE COMPANY AS TO "REFUNDS IMPROPERLY ORDERED."

It is the claim of the company that the commission has erroneously ordered it to refund to the telephone subscribers of Ohio entitled thereto the sum of $11,832,264.

In its order of January 16, 1934, the commission determined that the company had earned excess earnings over the period involved of $13,289,172 as a result of its intrastate operations, toll and exchange. However, the commission recognizing that under the laws of Ohio it probably could not require the company to repay to its subscribers in those areas where no protests had been filed to the increase in telephone rates, the amount of the excess payments to which they were entitled, deducted from the total excess earnings found by the commission the amount allocable to those communities aggregating $1,121,494.

The court will remember that under the law as it existed at the time of the institution of the various proceedings before The Public Utilities Commission involving an increase in the rates of The Ohio Bell Telephone Company in some forty-three Ohio communities, the company was permitted to put the increased rates into effect over the protest of the community concerned upon the giving of a bond guaranteeing the repayment to the subscribers of any excess rates collected thereunder if it

were subsequently determined that such rates were excessive, and the court will further remember that if no protests were filed the rates became effective in due course and in the opinion of the commission a refund could not be ordered because of the fact that no bond had been required to be given by the company, so that when the commission came to the consideration of the distribution of the $13,289,172 in excessive earnings collected by the company during the period involved it was confined to distributing this fund, or the proper proportion thereof, to those communities which had filed protests to the company's increased rates.

It has been pointed out heretofore in this brief that in 1924 there were some forty-three separate rate cases involving The Ohio Bell Telephone Company pending before the commission. At that time it was determined that all of these cases should be consolidated into a state-wide case for the purpose of determining the fairness of the rates being collected by The Ohio Bell Telephone Company. That was done and for approximately ten years the case proceeded before The Public Utilities Commission of Ohio as a state-wide inquiry into the rates of The Ohio Bell Telephone Company. When, on January 16, 1934, and in the findings subsequent thereto, the commission reached its determination that the company had been collecting excessive rates over the entire period involved and ordered the refunds to which reference has been made, the company insisted that for the purpose of determining the parties entitled to these refunds the commission should now retrace its steps and have introduced

before it evidence as to the value of the property and the revenues and disbursements of each separate community for the purpose of determining whether or not the rates earned in that particular community had been excessive. In other words it was the contention of the company that substantially all of the evidence which had been produced before the commission over a period of ten years should be junked and the commission should start anew with the consideration of the valuation of the property for each separate exchange at approximately the same place where the commission had left off in 1924 when the separate causes were consolidated into a state-wide case.

The commission frankly recognized that this method of determining the proper amount of refunds allocable to each community and to each telephone exchange was one method by which the amounts of these refunds could be determined, but the commission did not feel that this was the only method by which this could be done, and the commission was of the opinion that the delays that would be necessarily incurred by the application of the method urged by the company would be intolerable. It therefore approached the allocation of the refunds to the various communities entitled thereto upon the basis of its findings of excessive earnings accruing to the telephone company for the period involved in the following manner:

The question of allocation pertained first to the amounts applicable to exchange service and to toll service, and second, to the subdivision of the amount applicable to exchange service as between those exchanges where the rates had become effective without protest and those exchanges where protests had been lodged.

The commission decided that it would apply the entire refund in each year first to the reduction of exchange rates to the extent that such rates were covered by bond, and second, to the reduction of toll rates in those years where excessive earnings exceeded the amount of the exchange service bonds. Only one basis of allocation was found in the entire record upon which any allocation could be made affecting all of the exchanges in the entire territory served by the company during each of the years for which excessive earnings were found, and this basis was the amount of exchange service revenues received in each of the exchanges during each of the years. (R., 3797-9.) The commission was not satisfied that this basis, representing as it does the gross revenues of each exchange, would correctly measure the amount to be refunded to patrons paying excessive rates and that for those patrons the amounts collected under bond would provide the more reliable measure upon which refunds should be ordered. (R., 3797.) However, as bonds were only filed for those exchanges in which the rates were protested, this basis of allocation could only be used after first allocating the proportion of the excessive return to the protesting exchanges as distinct from the non-protesting exchanges. The preliminary allocation was therefore made between the protesting and non-protesting groups of exchanges on the basis of gross exchange revenues. (R., 3797.) This resulted in classifying $11,832,264 or 89.04% of the total excessive return as being refundable. The portions of this amount as they applied to each of the protesting exchanges in each of

the years was then compared with the annual amounts collected under bonds and by taking the lower amount for each year it was found that $11,423,137 was refundable in the protesting exchanges, leaving $409,127 of refundable revenues not allocable to protesting exchanges for the entire period. This $409,127 represented an excessive return of $232,282 in 1925 and $176,845 in 1926, and as both of these amounts were less than the total bond posted by the company for these years, the commission applied this against excessive toll earnings for those years.

When it is considered that the company is excused from paying $1,456,908 of the excessive earnings found by the commission to have been collected by it under bond in protesting exchanges for the reason that under the commission's interpretation of the law as it then existed only those communities were entitled to refunds which filed protests to the company's increased rates, and when it is considered further that the communities entitled to these refunds, with but one exception, have accepted without question the commission's method of allocating the refunds to the respective communities, we can see but little merit in the company's contention that the method was erroneous. We recognize of course the company's desire to overthrow this method of allocation in order that the matter may be referred back to the commission for further extensive hearings of long duration for the purpose of allowing the company to retain these excessive earnings for an unknown future period,

but we can conceive of little justification for the adoption of such a procedure.

In its brief, the company addresses its complaint against the commission's method of apportioning the excessive rates found by the commission to have been collected from telephone subscribers in the state of Ohio during the period involved to the various telephone exchange areas, by the use of factors other than separate findings as to the property value and net income for each exchange concerned. To have followed the procedure, as urged by the company, would have resulted in the institution of some forty-three or forty-four separate rate cases and the discarding of substantially all of the work that was done in connection with the state-wide case. The delay involved by so doing would have been intolerable. (R., 3714.)

Aside from the company's desire to open up separate rate cases for each exchange, it showed little, if any, willingness to introduce evidence of any kind pertaining to the individual exchanges for the purpose of determining the amount of refunds apportionable to each such exchange. So the only evidence introduced into the record on this question was as a result of the commission's orders of January 16, 1934 (R., 154-247) and March 1, 1934 (R., 273), and is contained in data furnished by the company on April 17, 1934. (R., 8425.)

Testimony produced in respect to such data reveals the company's unwillingness to enter into any discussion of a proper method of allocating the excessive revenues

found by the commission to have been collected by the company (R., 37, 91-96).

The company, in its brief, discusses repeatedly the evils occurring from the use of gross exchange revenues as the basis of allocating the refunds to the subscribers involved in this case. However, in reallocating refunds on what it deems the "commission's theory" wherein an alleged excessive refund of $4,640,364 is developed (Brett Ex. 9; R., 6347), the company has used gross exchange revenues exclusively as an allocation base. The method adopted by the commission as explained in the record (R., 3798-3799) and by Wood Exhibits 21 and 22 (R., 8193 and 8200) was not thus confined. It involved two steps, the first step being based upon gross exchange revenues for the group of exchanges entitled to refund and for the group of exchanges not entitled to refund. In this step, the total excessive return of $13,289,172 as found by the commission was separated upon the basis of $11,832,264 to the group of protesting exchanges and $1,456,908 to the group of non-protesting exchanges (Wood Exhibit 22; R., 8200). While the company criticises this step, its witness on the subject could offer no substitute method for it (R., 3791).

Prior to adopting the above-described method of allocation of refunds as between protesting exchanges and non-protesting exchanges, the commission had allocated $12,187,443 to the protesting exchanges and $1,101,729 to the non-protesting exchanges, based upon the hypothetical rate structure filed by the company (R., 3711-3738, 3746). However, the gross exchange revenue basis which

resulted in a lesser allocation to protesting exchanges and thus a reduction of the total amount refundable by the company was finally adopted by the commission as the first step in the proper allocation of the company's excessive earnings to those exchanges entitled thereto.

Having found a total of $11,832,264 in excessive rates collected by the company and applicable to the entire group of protesting exchanges wherein such rates have been collected under bond, in the manner previously described, the second step taken by the commission, required the allocation of this amount to the various exchanges entitled thereto. Now while the allocation on a gross exchange revenue basis, as used in the first step hereinbefore described, was considered reasonably accurate when applied to a broad base and where the law of averages could operate (R., 3753), it was recognized that it would not apply with the same degree of equity and accuracy where the base was narrowed to individual exchanges, wherein there existed the varying conditions described in appellant's brief (p. 69). For this reason, a basis of allocation in the second step was employed which gave weight to the varying amounts of bonded increases as between different classes of rates and different sizes of exchanges; to the relation which the increased rates bore to the pre-existing rates; to the character of the several exchanges furnishing the service, and to the cost of rendering that service. This basis was found in the amounts reported by the company as collected under bond in the various protesting exchanges.

This method also automatically limited refundable por-

tions of the excessive return for each exchange in each year to amounts not in excess of the total collections under bond in each exchange during each year. (R., 3768 and 3769.) In cases where such allocations exceeded such amounts collected under bond within an exchange area only the latter amount was considered refundable within such exchange area. Thus, of the total excess return of $11,832,264 in protesting exchanges only $11,423,137 was found to be refundable within such exchanges, leaving unapplied differences of $232,282 in 1925 and $176,845 in 1926. This total difference of $409,127 had not been collected under bond within any exchange area but nevertheless it represented excessive return to the company in those years and inasmuch as the company's statement showed excess collections had been made under bond for toll service of $510,142 in 1925 and $548,088 in 1926 the commission considered these differences of $232,282 in 1925 and $176,845 in 1926 as refundable toll revenues for those years.

Inasmuch as there is no localization of toll revenues as there is of exchange revenues, the excess toll revenues are state-wide in nature and are not subject to allocation geographically. The fact that the amount thereof was determined as a residue figure instead of by direct computation, diminishes rather than increases the total refundable amount. The commission considered refunds as being applicable first to exchange service patrons and second to toll service patrons, (R., 3774) but had it taken a reverse position and applied the toll service refund to the extent of collections under toll service bonds, the

amount of collections under such bonds of $4,981,394 would first have been refunded. The residue of the excessive return of $8,307,778 would have been allocated between protesting (approximately 89%) and non-protesting (approximately 11%) exchanges instead of the $13,289,172 that was so allocated. This would have resulted in a smaller amount applicable to non-protesting exchanges and consequently a smaller amount found to be non-refundable. But the refundable portion of the total excessive return of $13,289,172, consisting of $4,981,394 toll plus the reduced portion applicable to protesting exchanges (approximately $7,393,922) would have exceeded the $11,832,264 ordered refunded by over $500,000.

The company enters into a series of computations in its brief (pp. 70-71) by virtue of which it claims that had the commission eliminated non-bonded exchange service revenues in the Cleveland exchange from the allocation base used in the first step of its calculations, the results would have been to reduce the total refundable amount by more than $4,000,000. However, the company avoids carrying this argument beyond the Cleveland exchange. If it were proper to eliminate non-bonded revenues in Cleveland, would it not be equally proper to eliminate all non-bonded revenues in all protesting exchanges? If this were done, what would the result be? The answer is apparent. It would have to result in an allocation base for all protesting exchanges equal to the total bonded revenues in all protesting exchanges or $14,887,674 for the entire period from 1925 to 1932 both inclusive. And what use could be made of this figure in making the first

step of the allocation? There is no corresponding figure for non-protesting exchanges with which it could be compared or used for allocation purposes. (R., 3772, 3750, 3751.) The company's witness could suggest no available evidence in the record aside from gross exchange revenues that could be used in making allocations under the first step. (R., 3791.)

The figures purporting to be computed by the "Commission's Method" as shown in the company's brief (Column 7, p. 71) constitute a perversion of facts which the company persists in repeating with the inference that they are the commission's figures. Nowhere did the commission arrive at these figures and nowhere did they use them in arriving at their conclusions. They were first devised in Brett Exhibit No. 9, sheet No. 9 (R., 6356) in an amount of $5,467,766 wherein the percentages used by the commission in its first step were applied by the company in reworking the commission's second step on what the company chose to term the "Commission's Theory carried through to Conclusion on Basis of Original Method". They were referred to witness Wood for examination (R., 3798-9) and were commented upon by him in his report of August 11, 1934 (R., 8200) which contains quite complete explanations and points out further that in "carrying through to a conclusion" the company was not consistent in respect to toll refunds which would have been increased by $3,813,243 under their modified application of the commission's method. The company's whole point has been to pick out the gross exchange revenue percentages, which it

elsewhere severely criticizes as a base, that were used by the commission in the first step of its allocations, and to apply such percentages regardless of theory to all steps in the allocations, disregarding changes in residue toll figures resulting from such methods and then coming up with a set of hybrid figures which it infers are computed by the "Commission's Method". The excess earnings attributable to Cleveland as actually computed by the commission's method are as follows (Commission's Order of September 6, 1934, Schedule A; R., 378-9):

Year	Increases Collected Under Bond	Refundable Portion Collected	Excess Earnings Found Refundable
1925	86,717	100.00000%	86,717
1926	92,976	100.00000%	92,976
1927	99,160	95.59084%	84,788
1928	102,841	88.52068%	91,036
1929	113,937	62.67606%	71,411
1930	118,367	62.12778%	73,539
1931	115,487	73.06314%	84,378
1932	108,515	46.34134%	50,287
Totals	838,000		645,132

The record discloses that when the results of the method of allocating refunds as used by the commission were checked against the schedule of hypothetical rates submitted by the company on the order of the commission (R., 8425), carrying into effect the reduction in revenues found by the commission to be excessive they were substantially the same. (R., 3799, 8193, 8200.)

IV.

APPELLANT'S FINANCIAL EXPERIENCE.

Upon the basis of the commission's findings the appellant's book surplus at November 30, 1933 would be $10,682,929 after the payment of that portion of its excessive earnings found by the commission to be refundable to its subscribers in the amount of $11,832,264 while at the same time its reserve for depreciation would have been $14,652,468 instead of $21,999,901 as shown by the company's books. In other words, at November 30, 1933 the appellant should have had a book surplus of $22,515,193 with a reserve for accrued depreciation of $14,652,468. That the appellant has seen fit to deplete its surplus by excessive credits to its depreciation reserve in addition to excessive payments to American Telephone & Telegraph Company and Western Electric Company should not mislead any careful student of the facts.

Appellant states, in its brief (pp. 13 and 78) that its surplus was reduced approximately $1,000,000 between June 30, 1925 and November 30, 1933, and that the balance of the surplus account at the latter date was $2,813,345 from which it was ordered by the commission to pay the refund of $11,832,264 with interest. The period for which this refund applies is 1925 to 1932 inclusive and the commission, as has been discussed in previous chapters of this brief, determined that the gross income of the company during the period should have been $19,701,848 greater than the amount shown by the records of the company. The items comprising this total are detailed in lines 12, 13, 14 and 15 of Table 2:

Excessive Licensee payments	$2,870,218
Excessive Depreciation	16,115,738
Excessive Amortization	432,815
Excessive Western Electric prices	283,077
Total 1925-1932 inclusive	$19,701,848

Of the above amount, $13,289,172 represented excessive earnings but, as stated heretofore (pp. 128-131) only $11,832,264 was ordered refunded with interest. The understated net income (line 18) was therefore $7,869,584. Upon the basis of the findings of the commission as to license contracts, the proper rate of depreciation, and fair Western Electric prices, the company would have had on November 30, 1933, a surplus of $19,701,848 greater than the book surplus of $2,813,345 from which to pay the refund as ordered by the commission and still leave a net increase in surplus of $7,869,584 or a book surplus of $10,682,929 at November 30, 1933.

This deficiency in net income concerns only the items having a direct bearing upon the determination of rates for telephone service. Other items with which the commission was not concerned have contributed to a considerable extent to the decrease in surplus commented upon above by the company. Such items were purely the result of financial policies beyond the jurisdiction of the commission in regulating rates and its responsibility for their effect upon the company's surplus should not be inferred. For example, there were losses of over $3,000,000 on sundry items, representing principally the loss on preferred stock redeemed, the retirement of underlying bonds, the loss of purchased companies assumed, etc. (Wood Exhibit 4; R., 8179.)

TABLE II

	1925	1926	1927	1928	1929	1930	1931	1932	Total	
Intrastate:—										
1. Revenues	29,127,777	31,939,353	34,269,380	37,688,198	41,673,966	32,304,400	40,709,639	35,722,026	293,306,739	R. 8363
2. Expenses	23,171,103	25,271,407	27,058,031	29,182,575	33,520,373	34,287,243	32,725,410	28,683,150	234,199,292	R. 8363
3. Net Income	5,956,674	6,667,946	7,202,349	8,205,623	8,153,593	8,017,157	8,065,229	7,038,876	59,307,447	
As Found By Commission:										
Intrastate:—										
4. Revenues	29,860,295	32,621,359	35,091,386	38,0887645	41,849,739	42,405,306	40,884,960	35,745,348	296,376,958	R. 236-237
5. Less, Excessive Return	1,822,647	2,041,483	1,986,610	1,925,301	1,463,347	1,481,689	1,659,760	908,235	13,289,172	R. 244
6. Adjusted Revenues	28,037,598	30,579,876	33,014,776	36,083,344	40,386,392	40,923,617	39,225,200	34,836,993	283,087,786	
7. Expenses	21,478,044	23,456,132	25,242,219	27,514,103	30,952,802	31,454,219	29,782,552	27,487,582	217,367,663	R. 236-237
8. Net Income	6,559,524	7,123,744	7,772,557	8,569,241	9,433,590	9,469,398	9,442,648	7,349,411	65,720,123	R. 244
Difference in Intrastate Net Income:										
9. Line 8 minus Line 3	602,850	455,798	570,208	363,618	1,279,997	1,452,241	1,377,429	310,535	6,412,676	
Add, Excessive Return not refundable										
10. Exchange Service Revenues	433,170	227,324	162,753	153,063	118,723	124,100	140,355	77,420	1,456,908	Wood Exhibits 21-22
Total Difference Intrastate Net Income:										
11. Understated Net Income (Lines 9 and 10)	1,036,020	683,122	732,961	516,681	1,398,720	1,576,341	1,517,784	387,955	7,869,584	
Analysis of Understated Net Income:										
12. Excessive Licensee Payments	732,428	682,096	741,005	329,447	175,773	100,906	94,351	23,302	2,870,218	Intrastate percentages
13. Excessive Depreciation	1,635,563	1,756,299	1,757,276	1,908,980	2,520,223	2,758,913	2,744,479	1,034,985	16,115,738	shown in R. 243 ap-
14. Excessive Amortization	57,506	58,976	58,537	60,472	47,348	51,776	50,339	47,861	432,815	plied to total figures on
15. Excessive Western Electric Prices	.....	.....	.....	.....	.....	22,335	148,029	112,722	283,077	lines 19 to 22 below
16. Total Excessive Charges	2,425,497	2,497,281	2,556,818	2,298,919	2,743,344	2,933,930	3,037,199	1,218,870	19,701,848	
17. Less, Subscribers' Refunds ordered	1,389,477	1,814,159	1,823,857	1,772,238	1,344,624	1,357,589	1,519,405	830,915	11,832,264	
18. Understated Net Income	1,036,020	683,122	732,961	516,681	1,398,720	1,576,341	1,517,784	387,955	7,869,584	
Total Excessive Charges:										
19. Excessive Licensee Payments	751,975	703,387	765,739	331,626	182,583	104,555	98,047	23,973		R. 238—lines 7-8 and 15-16
20. Excessive Depreciation	1,682,354	1,810,102	1,820,433	1,983,073	2,633,250	2,883,043	2,883,538	1,083,904		R. 8178—L. 11 minus R. 242—L. 17 and 34
21. Excessive Amortization	59,293	60,577	60,346	62,721	49,934	54,740	53,374	50,230		R. 8175—line 35
22. Excessive Western Electric Prices	.....	.....	.....	.....	.....	23,208	154,284	117,028		R. 236 and 237

An important fact that must be constantly borne in mind in the consideration of this case is the ownership by American Telephone and Telegraph Company, either directly or indirectly, of more than ninety percent of the combined voting stock of the twenty-four companies associated with it as the Bell System. The American Company also owns ninety-eight percent of the Western Electric Company. It owns all of the stock of the Bell Telephone Securities Company and it has varying interests in other affiliated companies. (R., 6774.)

Under such circumstances excessive payments made by the appellant to the American Company for license services as well as payments to the Western Electric Company for its telephone equipment at excessive prices must be construed as merely diverting income from one member of an affiliated group to another member thereof and the adverse showing in the recorded surplus of The Ohio Bell Telephone Company is, of necessity, offset by an increase in the earnings and surplus of other members of the affiliated group.

An example illustrative of the ease with which intercompany profits in the American System may be earned was more fully discussed under the chapter on depreciation. There it was stated that the American Telephone and Telegraph Company sold to the operating companies telephone instruments for $14,395,800 in excess of book value and this amount was added to its surplus account. The portion of the profit on these instruments charged to The Ohio Bell Telephone Company and capitalized was $595,986.

As stated in Appendix M of the commission's order of January 16, 1934 (R., 244) the rates of return allowed on present value were as follows: 1925-1929 inclusive, 7%; 1930 and 1931, 6½%; 1932 and 1933, 5½%. The rates actually realized by the company upon the basis of the commission's findings on its intrastate business during these years were as follows: 1925, 8.95%; 1926, 9.01%; 1927, 8.79%; 1928, 8.57%; 1929, 8.09%; 1930, 7.52%; 1931, 7.64%; 1932, 6.18%; 1933, 5.51%. The average for the nine-year period was 7.71%. The average reasonable rate determined by the commission for the same period was 6.5%. The reasonableness of the rates of return allowed by the commission is not challenged by the company, but in connection with the financial experience of the company it is of interest to appraise the company's earnings in the perspective of the entire American System. For example, David F. Houston, president of the Bell Securities Company, which is owned entirely by the American Company, stated in 1922 that in order for the American Company to pay dividends of 9%, the operating companies need earn only 4.7% on their investment, due to the high degree of cooperation possible in such a system. (R., 6774.) During the years immediately following Mr. Houston's statement, the surplus of the American System increased 62%. (R., 6776.) Clearly, he had in mind the fact that the Western Electric Company manufactures equipment used by the operating companies and bills these companies at prices including substantial profits and the operating companies pay to the American Company certain percentages of their

gross income under the caption of license payments treated as expenses by the operating companies. The earnings of The Ohio Bell Telephone Company are distributed to the American Company in the form of dividends. These dividends, when declared and paid, are charged against The Ohio Bell Company's surplus. If, in 1933, the latter's surplus was badly depleted as claimed by the company and since the dividend policy of The Ohio Bell Company has been determined and fixed by the American Company, the latter company might now be expected to refund a portion of the excess payments made either in the form of dividends, license payments, excessive Western Electric prices, or the profit made from the sale of telephone instruments.

As stated in the chapters entitled "Depreciation", the reserve for depreciation at December 31, 1933, was $21,999,901. The percent condition, as determined by the commission, was 91.21% which would indicate that a reserve of $14,652,468 would be ample and that the company's reserve was $7,347,333 excessive. In making the proper adjustment of this depreciation reserve, this amount would be credited to the company's surplus partially offsetting the charge for refunds.

The fact is, as stated in the chapters on "Depreciation" and "License Contracts", that the company in 1933 was using substantially the same rates as those prescribed by the commission in determining excessive earnings for this nine-year period. The depreciation rate voluntarily adopted by the company in 1933 was 4.18%. The commission prescribed 4%. The Ohio Bell Telephone Com-

pany was paying the American Company 1½% of its gross revenue for license payments. The commission made no reduction in this item. How can the company, in light of its own voluntary action adopting these rates, charge the commission with confiscating its property? In the chapter on "Depreciation" if was definitely established that the company failed to record $9,919,920 of depreciation reserves on property purchased and that the company charged excessive rates during the period of abnormal replacements in order to accumulate sufficient balances in their reserves to absorb these abnormal charges.

The commission has clearly demonstrated from the facts in this record that the earnings of The Ohio Bell Telephone Company from 1925 to 1933 were excessive. The company furnished bond at the beginning of this rate study that all earnings determined to be excessive would be refunded. It now takes the position that its surplus account is depleted as a result of excessive dividend payments to the parent company and will not stand the charge of the refund payments. Prudent accounting would have resulted in a reserve adequate to meet this payment instead of the $2,500,000 which the company in 1933 carried in its balance sheet for this purpose. The statement that the company is now unable to make this payment must be branded as pure fiction.

CONCLUSION.

The judgment of the Supreme Court of Ohio, affirming the orders of The Public Utilities Commission of Ohio, should be affirmed.

Respectfully submitted,

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March 27, 1937.

APPENDIX.

Pence Law, p. i.
Valuation Sections, Ohio General Code, p. v.
Section 614-23 of the General Code, p. x.

Pence Law.

The Pence Law, Section 614-20, passed April 4, 1923, 110 Ohio Laws, 366, which amended the Robinson Law, is as follows:

> "Unless otherwise ordered by the commission, no change shall be made in any rate, joint rate, toll, classification, charge or rental in force at the time this act takes effect, or as shown upon the schedules which shall have been filed by a public utility in compliance with the requirements of this act, or by order of the commission, except after thirty days' notice, in writing, to the commission, which notice shall plainly state the changes proposed to be made in the schedule then in force, and the time when the change, rate, charge, toll, classification, or rental shall go into effect; and all proposed changes shall be plainly indicated upon existing schedules, or by filing new schedules thirty days prior to the time when they are to take effect, but the commission may prescribe a less time when they make take effect, provided, however, that if the proposed change shall effect an increase in the rate, joint rate, toll, classification, charge or rental, notice, in form approved by the commission, published once each week for three consecutive weeks before the effective date thereof, unless the commission shall authorize a less time, shall be given by publication in a newspaper published at the county seat of each county in which such change applies, and of general circulation therein, or in one newspaper published in, and of

general circulation throughout the territory in which such utility operates. Such published notice shall set forth the fact that such application has been made, the effective date of the proposed new schedule, the name and location of the agent of the utility in such county or territory where a copy of such proposed new schedule may be inspected by any interested party; and provided, further, however, that such utility shall at the time of the filing of the schedule with the commission, place on file with such agent of such utility a copy of the proposed new schedule and keep the same on file for the inspection of any interested party pending the hearing before such commission.

Whenever there shall be filed with the commission any schedule effecting an increase in any rate, joint rate, toll, classification, charge or rental, or stating any new regulation or practice affecting any existing rate, joint rate, toll, classification, charge or rental in force at the time this act takes effect, the commission shall have, and it is hereby given authority, either upon complaint, or upon its own initiation without complaint, at once, and if it so orders without answer or other form of pleading by the interested public utility, but upon reasonable notice, to enter upon a hearing concerning the propriety of such rate, joint rate, toll, classification, charge, rental, regulation or practice; and pending such hearing and the decision thereon, the commission upon filing with such schedule and delivering to the public utility affected thereby, a statement in writing of its reasons for such suspension, shall suspend the operation of such schedule and postpone the use and operation of such rate, joint rate, toll, classification, charge, rental, regulation or practice, but not for a longer period than one hundred and twenty days from the time when such schedule was filed with the commission; and after a full hearing, whether completed before or after the rate, joint rate, toll, classification, charge, rental, regulation or practice goes into effect,

the commission may make such order in reference to such rate, joint rate, toll, classification, charge, rental, regulation or practice as would be proper in a proceeding initiated after the rate, joint rate, toll, classification, charge, rental, regulation or practice had become effective; provided, that if any such hearing cannot be concluded within the period of suspension, as above stated, such rate, joint rate, toll, classification, charge, rental, regulation or practice shall go into effect at the end of such period of suspension upon the public utility filing with the commission a bond, undertaking or other security, to the satisfaction of the commission, securing and guaranteeing the repayment, with interest at the rate of six per centum per annum from the date of payment by the consumer to the date of repayment by the utility, to all the consumers of such portion of such increased rate, joint rate, toll, classification, charge or rental, collected by such utility as the commission, upon final hearing, may determine to have been unreasonable or excessive, which repayments shall be made at such times and in such amounts as the commission shall order, and shall be promptly paid by said utility to the corporations or persons entitled thereto, and in such manner as the commission may prescribe, and if any such money ordered by the commission to be repaid shall not have been claimed by the corporations or persons entitled thereto, within one year from the time the same shall become due and payable in accordance with the order of the commission, all such moneys shall be paid by the utility to the treasurer of the county, or other political subdivision, in which such new schedule is effective for the benefit of its general fund, in such amounts and in such manner as the commission may order; and thereafter such public utility shall not be liable therefor. Such bond, undertaking or security shall be in such amount as the commission may from time to time determine; provided, however, that the amount fixed at any time shall not, in addition to the amount of such increase

or other charge made by the utility already accrued, exceed the estimated amount of such increase or other charge made by the utility extending over a period of one year, based upon the business of the utility for the previous year, or be less than one-half of such estimated amount.

All rates, joint rates, tolls, classifications, charges or rentals of a public utility heretofore or hereafter fixed and determined by any order the commission under the provisions of this chapter shall be in force and be prima facie lawful for two years from their effective date or until changed or modified as provided by law, provided, however, that after any such rate, joint rate, toll, classification, charge or rental shall have been in force for a period of two years, the same may be changed by the public utility affected in the manner provided in this section; and that nothing herein contained shall be construed as in any way affecting the right of any person or public utility to make application, as provided in Sections 614-21 and 614-23 of the General Code or otherwise as provided by law, for an order rescinding, altering or amending any order of the commission within said two-year period or thereafter.

At any hearing involving a rate increased or sought to be increased after this section shall have become effective, the burden of proof to show that the increased rate or the proposed increased rate is just and reasonable shall be upon the public utility and the commission shall give to the hearing and decision of such question, preference over other questions pending before it, and decide the same as speedily as possible."

Valuation Sections, Ohio General Code.

Sec. 499-8.

The commission, for the purpose of ascertaining the reasonableness and justice of rates and charges for the service rendered by public utilities or railroads of this state, or for any other purpose authorized by law may investigate and ascertain the value of the property of any public utility or railroad in this state, used or useful for the service and convenience of the public. At the request of the council of any municipality the commission after hearing and determining that such a valuation is necessary may also investigate and ascertain the value of the property of any public utility used and useful for the service and convenience of the public where the whole or major portion of such utility is situated in such municipality. Every public utility or railroad shall furnish to the commission, its engineers, experts or other assistants from time to time and as the commission may require maps, profiles, contracts, reports of engineers and other documents, records and papers or copies of any or all of the same, in aid of any investigation and ascertainment of the value of its property, and shall grant to the commission or its agents free access to all of its premises and property and its accounts, records and memoranda whenever and wherever requested by any such duly authorized agent, and every public utility or railroad is hereby directed and required to co-operate with and aid the commission in the work of the valuation of its property in such further particulars and to such extent as the

commission may require and direct. The commission shall have such power to make all rules and regulations, as to it may seem necessary, to ascertain the value of each and every utility or railroad in the state. (106 v. 225; 103 v. 808, §21.)

Sec. 499-9.

The commission shall prescribe the details of the inventory of the property of each public utility or railroad in the state; and such inventory shall include all the kinds and classes of property, with the value of each, owned by each public utility or railroad, used and useful for the service and convenience of the public. In ascertaining the value of the various kinds and classes of property of each public utility or railroad, the commission shall have authority to ascertain and report in such detail as it may deem necessary as to each piece of property owned or used by such public utility or railroad to show separately the following facts:

A. The original cost, if any, of each parcel of land owned and used by such public utility or railroad, and a statement of the conditions of acquisition; whether by direct purchase, by donation, by exercise of the power of eminent domain or otherwise.

B. The value as of a date certain, of each parcel of land owned and used by such public utility or railroad, by comparison with the value of contiguous and neighboring parcels of land, and land of similar character as to location and use.

C. If there shall be any additional value to such utility or railroad by reason of the ownership by it of one or

more parcels of land and its use as a continuous right of way for transportation purposes, or for other purposes, such additional value shall be separately and specifically set forth for each parcel.

D. The cost of new production as of a date certain, of all physical property other than land, owned and used by such public utility or railroad, showing the values of the separate items comprising such property, together with the unit basis of such valuation.

E. Depreciation, if any, from the new reproductive cost as of a date certain, for existing mechanical deterioration, for age, for obsolescence, for lack of utility or for any other cause, the percentage and amount of each class of depreciation, if any, to be specifically set forth in detail.

F. The net value as of a date certain, of all physical property other than land owned by such utility or railroad, to be derived by deducting the sum of the amounts of depreciation from the sum of the new reproductive costs.

G. If there shall be any additional value given to the value of the property of a public utility or railroad due to the possession of a franchise to perform a public service, or for good will or for financing, such additional value shall be separately and specifically set forth, together with the basis for the computation or estimate of such additional value.

H. A duplicate copy of the record of every physical valuation of a public utility or railroad shall be furnished to the Ohio tax commission, on request, for its use in

ascertaining the value of the property of such utility or railroad for purposes of taxation, and upon demand any person or corporation owning or operating a public utility or railroad shall be furnished with a copy of the valuation of his or its property.

Such investigations and report shall show separately the property used and useful to such utility or railroad in the furnishing of the service to the public, and the property held by such utility or railroad for other purposes, and such other items concerning values and methods of making valuations as the commission may deem proper; which said inventories and reports shall be filed in the office of the commission for the information of the governor and the general assembly. (103 v. 809, § 22.)

Sec. 499-10.

Such investigation and report shall also show whenever the commission may deem necessary, the amounts and dates and rates of interest of all bonds, outstanding against each public utility or railroad, the property upon which they are a lien, the amounts paid therefor; and, in such detail as may be necessary, the original capital stock and the moneys received by any such utility or railroad by reason of any issue of stock, bonds or other securities. Such report shall also show the net and gross receipts of such utility or railroad and the method by which moneys were expended or paid out and the purpose of such payments. The commission shall have the power to prescribe the method of procedure to be followed in making the investigation and valuation and the form in which the results of the ascertainment of the

value of each utility or railroad shall be submitted, and the classifications of the elements that constitute the ascertained value. Such investigation shall also show the value of the property of every public utility or railroad as a whole; and in case such utility or railroad has property in more than one county, the value of its property in each of such counties. (103 v. 810, § 23.)

Sec. 499-11.

The commission, during the making of the valuation herein provided for, and after the completion thereof, shall thereafter in like manner keep itself informed through its engineers, experts and other assistants of all extensions and improvements or other changes in the condition and value of the property of all public utilities or railroads and shall ascertain the value of such extensions, improvements and changes and shall from time to time, as may be required for the proper regulation of such public utilities or railroads, revise and correct its valuations of property, showing such revisions and corrections as a whole and as to each county in the state. Such revisions and corrections shall be filed in the same manner as is provided for original reports. (103 v. 811, § 24.)

Sec. 499-12.

The commission, whenever it shall have completed the valuation of the property of any public utility or railroad and before such valuation shall have become final, shall give notice by registered letter to such public utility or railroad, or if the whole or the major portion of said utility or railroad is situated in any municipality,

then to the mayor of such municipality, stating the valuations placed upon the several kinds and classes of property of such public utility or railroad and upon the property as a whole. If within thirty days after such notification no protest shall have been filed with the commission then said valuation shall be and become final. If notice of protest shall have been filed, however, by any public utility or railroad, the commission shall fix a time for hearing the same and shall consider at such hearing any matter material thereto presented by such public utility or railroad or municipality, in support of its protest or by any representative of the public against such protest. If after the hearing of any protest of any valuation so fixed, the commission shall be of the opinion that its inventory is incomplete or inaccurate or that its valuation is incorrect it shall make such changes as may be necessary and shall issue an order making such corrected valuations final. A final valuation by the commission and all classifications made for the ascertainment of such valuations shall be public and shall be prima facie evidence relative to the value of the property. (103 v. 811, § 25.)

Sec. 614-23 of the General Code of Ohio.

Sec. 614-23.

Whenever the commission shall be of the opinion, after hearing, that any rate, fare, charge, toll, rental, schedule, classification or service, or any joint rate, fare, charge, toll, rental, schedule, classification, or service rendered, charged, demanded, exacted or proposed to be rendered,

charged, demanded, or exacted, is, or will be, unjust, unreasonable, unjustly discriminatory or unjustly preferential or in violation of law, or the service inadequate, or that the maximum rates, charges, tolls or rentals chargeable by any such public utility are insufficient to yield reasonable compensation for the service rendered, and are unjust and unreasonable the commission shall, with due regard among other things, to the value of all of the property of the public utility actually used and useful for the convenience of the public, excluding therefrom the value of any franchise or right to own, operate or enjoy the same in excess of the amount, (exclusive of any tax or annual charge) actually paid to any political subdivision of the state or county, as the consideration for the grant of such franchise or right; and exclusive of any value added thereto by reason of a monopoly or merger and to the necessity of making reservation out of the income for surplus, depreciation and contingencies, and all such other matters as may be proper, according to the facts in each case, fix and determine the just and reasonable rate, fare, charge, toll, rental or service to be thereafter rendered, charged, demanded, exacted or collected for the performance or rendition of the service, and order the same substituted therefor; and thereafter, no change in the rate, fare, toll, charge, rental, schedule, classification or service, shall be made, rendered, charged, demanded, exacted or charged by such public utility without the order of the commission and any other rate, fare, toll, charge, rental, classification or service shall be deemed and held to be unjust and unreasonable, pro-

hibited and unlawful. Upon application of any person or any public utility, and after notice to the parties in interest and opportunity to be heard as provided in this act for other hearings, has been given, the commission may rescind, alter or amend an order fixing any rate or rates, fare, toll, charge, rental, classification or service, or any other order made by the commission. Certified copies of such orders shall be served and take effect as provided for original orders. (102 v. 556, § 25.)